Conference Call Transcript — 2Q13 Results — August 7th, 2013

Operator:

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to América Latina Logística ALL's 2Q13 earnings conference call. Today with us we have Alexandre Santoro, CEO, Rodrigo Campos, CFO and IRO, and Pedro Albuquerque, IR Superintendent for ALL.

We would like to welcome everyone that this event is being recorded, and all the 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 session. At that time, further instructions will be given. Should any participant need assistance during this call, please press *0 to reach the operator.

We have a simultaneous webcast that may be accessed through ALL's IR website, at 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 beliefs and assumptions of ALL management on information currently available to the Company. They involve risks, uncertainties, and assumptions because they are related 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 ALL and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I 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. Alexandre Santoro, CEO, will start the presentation. Mr. Campos, you may begin the conference.

Rodrigo Campos:

Good morning. Thank you, everyone, for holding this 2Q conference call of ALL. Just some brief comments here on the numbers we are releasing here. The first comment is on the adjusted EBITDA; this adjusted EBITDA is according to the methodology of CVM, which was released at the end of last year. So, all the numbers of 2013 are in the new methodology and for better comparison also the numbers of 2012 are also in this new methodology. So, the numbers of 2012 may differ a little bit from the previously released numbers in terms of adjusted EBITDA.

One more comment on the released numbers, you know that we are trying to leave our operations in Argentina since 2012, and it was largely announced that our concessions in Argentina were rescinded in June 5th. So, since then we do not incorporate the concessions in Argentina anymore, and therefore the results coming from ALL Argentina are now presented as a result of discontinued operations in a separate line of our income statement. So, numbers of Argentina are not consolidated on our numbers anymore and are shown in a separate line. This is done 2013, and for a comparison basis it is also done in 2012.

With that, I would like to transfer to Alexandre Santoro in order for him to start the presentation.

Alexandre Santoro:

Good morning. Thank you, everyone. We will start now with a summary about our 2Q results. First of all, our consolidated EBITDA grew 13%, on the rail operation 12%, Brado 25%, and Ritmo 32%. We concluded successfully the capitalization of Brado. We started our operation in Rondonópolis yesterday, and on the other hand the volume did not grow, even in a good cost scenario, it was impacted by port restrictions that we will explain further.

And ALL Argentina, as Rodrigo said, an operation that did not contribute to our results and has been demanding a disproportional focus by the management. Looking in more details, our EBITDA grew 13% impacted by various fields in the rail operations and a good quarter of Brado and Ritmo. Our 1H EBITDA grew 14% to almost R$1 billion.

Talking about volume, in the 1H we grew 3%, positively impacted by a 6% increase in agricultural commodities and a 5% reduction in industrial products. But improved when compared to the last quarter the industrial products. We were impacted by capacity restrictions and the port we serve and our volumes did not grow as we expect in the 2Q.

We had a good market condition, but those restrictions at the port made our volume the same as last year. We had a favorable cost scenario. This positive market environment was *[audio break]* with material volume growth, as we done historically. Important to mention that we have faced different problems at the Port of Santos: reduction in the capacity at the terminals we serve had a different impacted on our productivity. The ports became an important bottleneck due to strike, restrictions at important terminals, and excessive rains, more than double of last year. The yields increased 12% reflecting the pass through inflation in diesel on our contracts and the recovery of freight price in the spot market.

When we look at Brado, the volume grew 30% with gains in the main corridors and a 25% in the EBITDA. We are proud to announce that we concluded the capitalization of R$400 million through a capital injection by FI-FGTS. This quarter is valued at R$1.4 billion pre-money and R$1.6 billion post-money. ALL will hold 62% of the company and this injection will help the Company to deliver consistent growth in the future as we planned.

When you look at the other business that we have, which is Ritmo, our EBITDA increased 30% to R$7 million at the 2Q, and the volumes increased 16% pushed by a good growth in intermodal volumes.

Talking now about the Rondonópolis project. You know that we concluded the investment on the expansion of our large gauge rail network to Rondonópolis in the end of 2012. We had just obtained the operational license from IBAMA and started the operation yesterday. We started the testing period and volumes should grow gradually, and we believe that we will be at full capacity at the middle of September. It is an important step in our history and made us very proud to see this brilliant project operational.

The Argentinean government, talking now about Argentina, we started the concessions of ALL in the country, but as we informed before, the Company was planning to discontinue its operations there. The results for this operation represented a minimum share of ALL consolidated results that has been demanding disproportional focus.

Now I will ask Rodrigo, our CFO, to present more details about the results. Then I will come back with additional comments at the end of the presentation. Thank you.

Rodrigo Campos:

Thank you, Santoro. Going to slide six, which shows ALL's consolidated results, you can see that adjusted EBITDA increased almost 13% in the 2Q to R$580 million, more and less, and grew 14%, close to R$980 in the 1H13.

Our net income in the 1H13 was negative in R$40 million, and this was basically because of the impact of the discontinuation of our operations in Argentina. We know that we used to have the concessions there; as we do not have any more, you the impairment of the PPE, the CAPEX we have there, also of fiscal credits we have there. So, we made all the impairments, the accounting, which generated a negative accounting impact this quarter. If we exclude the results of operations in Argentina, our net income reached almost R$212 million in 1H13, which represents a 30% growth as compared to last year.

Going to slide seven, looking to the rail operations, you can see that the volumes were virtually the same in the 2Q as compared to the past year, which surely is not what we expected. We expected to grow but we faced capacity restrictions on the ports that we will explore a little bit further. And in the 1H13 the volume increased 3% as compared to the last year.

The average tariff grew 11.7% in the 2Q and 10.2% in the 1H13, which reflect basically the inflation pass through and the increase in diesel price to our take-or-pay agreements and also an improvement and a recovery of the freight prices in the spot market. So, it was a good quarter in terms of pricing.

And the adjusted EBITDA of our rail operations reached R$560 million in the quarter, from R$500 million in the same period of last year, with a margin expansion of 0.4% in the quarter. In the 1H EBITDA grew almost 14% to R$943 million.

Going to slide eight, when we show the performance of our agricultural commodity business, the volumes in the quarter increased 0.4%, and here this volume was pretty much impacted by the performance on the cost. We know that we face a good market environment, but I mean ports became an important bottleneck for our operation this quarter. We know that you must see logistics as a system. When you look at logistics, you have the trucking connections, the terminals on countryside, you have the railroad, then you have the port, and everything must work as a system. As the port does not work, which was the case in the 2Q, also in the month of March we already faced some problems on the ports, it impacts all the productivity and all the system in the railroad, in the rolling stock after, so it has a very important impact in our operations.

And when you look at ports, we have a very good market, we have an increase in the traffic of trucks inside the port, which increases the traffic jam on the port; also we had some strikes on the port in May and also in March. And we had some specific impacts in terminals, which are very important terminals for the railroads, especially in the Port of Santos.

If you take the Port of Santos in the quarter, the TGG, which is the main terminal in terms of unloading for the railroad, it represents almost 40% of the day-to-day unloading of the railroad, had a fire incident, which burn one of the four towers of the terminal of TGG in June. So, this was the one incident.

Another incident we faced was in the terminal 39, where a ship hit one of the two shiploaders of the terminal and destroyed the shiploader, so the terminal is starting to operate with 50% of the capacity. Now the terminal 39 is working changing the maneuvering of the ships, creating additional maneuvering to take advantage, to improve the productivity of the shiploader, which is operational nowadays but it also affected the capacity of the ports on quarter.

And in the sugar terminals our clients have a plan of increasing the capacity of those terminals. They have works of expansion of capacity of these terminals, but this work should be concluded only in August. And during the works, the capacity of these terminals is 30% below last year.

So just to summarize on Ports here, we have a pressure on the demand for the ports, much higher traffic of trucks inside the port. And at the same time, we have problems on very important terminals during this quarter; at least part of these problems will be solved along the 3Q and in the 4Q.

So that is the performance we saw on the port, which impacted the performance of our agriculture commodity business in the quarter. So at the end, in the 2Q we grew volumes at 0.4%, and in the year, when we see 1H13, agricultural volumes are growing 6% as compared to the same period of last year.

In slide nine, we see that net revenues grew almost 30% in the quarter, basically reflecting a yield growth of 12% and a marginal volume growth. Adjusted EBITDA increased 15%, and here is important to mention an improvement in the margins from 62.4% to 63.7%, so a margin improvement over 1 p.p. in the quarter, and in the 1H the EBITDA increased

18%, with an expansion in EBITDA margin of 0.6%, as compared with the same period of last year.

In slide ten, we will show our industrial products business. During the quarter this volume decreased more or less 2% as compared to the same period of last year, which is a negative number, but an improvement if you compare with the previous quarters. We know that the industrial business was the separate activity in our area, also with some changes in some of our clients' operations. But now we are ramping up volumes in the industrial business and we are improving as compared with the previous quarter.

And this improvement is a result basically of the ramp up of the operation with our client Eldorado, which is a project that, when it is in the steady stage, will be a project of one million tons annualized volume, so it is a good project. And also the recovering in volumes is related to the improvement in volumes of containers, basically through our client volumes.

When we go to slide 11 we see that net revenues of the industrial segment increased 6.2%, EBITDA was almost in line with last year, around R$90 million, but EBITDA margins in the industrial segment went down basically because of the mix between transported products. I mean, we increased the volumes of containers, which are volumes that naturally have smaller margins, and remember that Brado is now the CAPEX in order to grow containers at the railroad. So, as a counterpart there is a discount, so it means that tariffs for Brado are lower, which generate a mixed effect. And of course, the volumes are a little bit lower than last year, which means that the operational leverage of the railroad and with an impact in margins at the end of the day.

When we go to page 12, we see that Brado had a very good quarter. Volume is increasing 30% as compare with last year, with an important volume increase in all four corridors of Brado. So, volumes are growing 45% in wide gauge corridor, 30.6% in Mercosul corridor. Remember that Mercosul was a corridor where volumes of Brado were decreasing, so they are starting to recover volumes in Mercosul. Brado had all the problems with customs restrictions in Argentina, which reductions of imports from Brazil in in Argentina, so volumes are recovering, which are good news. In Paraná volumes also increased almost 40%, which is also good news, and volumes increased 17% in Rio Grande corridors at Brado.

And on slide 13, net revenues of Brado increased 20%, reaching R$66.4 million, and EBITDA of Brado increased 25% in the 2Q, with a margin growth of 0.7%. In the 1H, the net revenues grew 22% in Brado, which is more or less the growth in the adjusted EBITDA in the 1H13.

Going to slide 14, we see the result of Ritmo. Ritmo is our truck subsidiary, and also had a very good quarter in terms of volumes and in terms of EBITDA. The volume increased 16%, supported basically by an increase in the volumes of our intermodal unit. Remember that when we created Ritmo, the intermodal transportation, which are these trucking connections that you must do to feed the railroad, was the main opportunity we used to see for Ritmo, and Ritmo is increasing volumes quarter over quarter as compared with last year. So, in the 2Q volumes in the intermodal units increased 80% and in the 1H volumes grew 90% as compared with the same period of last year.

In the other unit, in general cargo and specialized assets volume grew 8% in the 2Q and 3% in 1H. And in automotive segment, we see reducing volumes, the same trend we had in the previous quarters, as we left some role of profitable operations and just concentrated our focus on operation which have better margin.

So as a result, we see in page 15, our net revenue grew 10%, but adjusted EBITDA grew 32% in the 2Q, from R$5.4 million to R$7.1 million, gaining margin from 8.9% to 10.7% in the 2Q. So, the margin improvement reflects the focus on profitable operations and also increasing the scale of our intermodal business, as volumes have been growing quarter over quarter. And in the 1H net revenues grew 8.2% and EBITDA grew 23%, also with a material margin growth from 9.2% to 10.4%.

When we go to slide 16, we have our consolidated revenues. Important to mention that when you compare 1H12 to 1H13, effects of Argentina are not part of consolidated net revenues anymore, because it shows in a separate line of our income statement. So, revenues grew 14% in 1H13 as compared with 1H12, and EBITDA increased 14%, slide 17, with consolidated margins stable at 52%.

Important to mention that when we look business by business, all margins are growing; it is growing in rail business, it is growing in trucking business, it is growing in container business. But even the mix that our container business and our trucking business are growing more than the rail, and those are businesses that have lower margins, the consolidated margins are stable when you compared year over year, at 52%.

When we go to slide 18, we show our net income. Our net income, as we mentioned before, is -40%, but when you exclude those impacts that would be around R$220 million, with 13% growth as compared with last year.

In slide 19, we show the leverage of our balance sheet, the net debt/EBITDA, and the 1H in 2.4x net debt/EBITDA having declining since the end of 2012.

And with that, I would like to transfer the presentation to Alexandre Santoro.

Alexandre Santoro:

Thanks, Rodrigo. And just to conclude, and first of all CAPEX is really progressing as expected, in line with our long-term guidance of R$700 million.

The second point is about volumes. We faced a market scenario favorable, but the capacity restrictions at the ports we serve should extend through the 3Q. There are several infrastructure improvements expected to be in place on the following months. At the same, we have some projects that will help us to increase our volumes on the industrial products, like Vale do Rio Doce, Votorantim, Eldorado, ethanol, and Brado. In the third is Rondonópolis that yesterday we started operations and we will go through a testing period, and volumes should grow gradually.

Now I will open for the questions you have, and we will be happy to answer you. Thank you.

Mark Suarez, Euro Pacific Capital Inc.:

Hi, there. Good morning, everyone. Just to go back, you were talking about the capacity limitation at both terminals at the Port of Santos in addition to the construction work that you are trying to increase capacity at the sugar terminal. If we put all those things together, the bottleneck as you mentioned in the press release, how should we think about agricultural volumes through the end of the year?

Rodrigo Campos:

Mark, when we look at the port, we should still see restrictions in the port in the 3Q, and in July it was a month that had an additional impact, because the rainfalls in Santos was double of the same period of last year. So, it contributed with all the scenario of impacting capacity, the moving capacity of the terminals on the Port. But there are a lot of things going on in order to recover the capacity in the terminals which were affected by accidents, particularly TGG and terminal 39. And in sugar terminals, the works of expansion should be completed in August. So if we take the TGG, the recovery of the tower, which was fired, should be completed only in the 4Q, in October, maybe in November, so these restrictions should be there.

But in terminal 39, I lost one of the two shiploaders, which reduces the current capacity of the terminal by 50%, but the terminal now sat with the ships and other procedure where the ships do additional maneuverings and increase the productivity of the existing shiploader. So, at the end of the day, part of the lost capacity should be recovered in this current process. And estimates are that in September the shiploader, which was lost by this accident, should be back.

And the terminals of sugar are operational, but they should be with their works concluded in August. So, along the quarter we should see some of the capacity restored, so in the 4Q we should have a port much more in line with what would be normal.

I do not want to anticipate any projection of volume for the quarter or the 2H. We normally do not give that. Market should be good also, as it was in the 1H, but there are still some restrictions on the port. What I believe when I look ahead is that port can be a huge opportunity for our business, because you are looking that, probably you are hearing that the Government has a new model for the port. The Government intends to put, to bid again some of the existing ports, and the model that the government is prioritizing is a model that focuses on productivity gains. So, today in the Port of Santos, for example, you have a terminal like TGG, which moves like 7 million tons per year in each berth, and there are terminals that, by the end of the day, move like 1.5 million tons in each berth per year.

So, it is not acceptable that in the Port of Santos terminals move less than 5 million tons in a berth. Berth is the main restriction that we had in the Port of Santos, new berths cost a lot of money, there are projects of new berths, which are more long term. But we could improve a lot in the short to medium term the capacity of the port only making marginal investments and gaining productivity in the existing terminals. So, there is no problem in having a private terminal, a private berth, but if you only move like 1.5 million tons, you should attend other guys and you should have goals of volume movement in your terminals. And this is the model that the Government wants to follow. And there are some bids that should be on market at the end of this year.

So, we look carefully for the port. I believe that few things have so many synergies as railroads and ports. If you have a port which is efficient, which generates a big gain in terms of productivity of the railcars, of locomotives, with the same railcars and locomotives you can transport much more, and at the same time the railroad can migrate, can bring a lot of cargo for the port's terminal, so there is a lot of synergies in both businesses.

But independently of ALL's managing terminals on the port or a third guy managing the terminals on the port, the important thing is to have a productive port, and I believe the model of the Government is very focused on that.

Mark Suarez:

That was very helpful. Now, you mentioned Rondonópolis, you started basically transporting since August 6th through the Rondonópolis line. Would the bottlenecks at Port of Santos impact that ramp up as you reach presumably full capacity or at least near capacity, as you are projecting September of this year? Would that have any impact whatsoever?

Rodrigo Campos:

No, the ramp up of Rondonópolis is basically operational. Our agreement with the clients already has a prevision of hauling from Rondonópolis. We have tariffs hauling from Alto Araguaia and tariffs already hauling from Rondonópolis, so this migration is something that is relatively easy. But there is the normal operational ramp up; you have all the engines of the terminal, the team of the terminal that will be set in order and it will be set with this ramp up of growing volumes.

The port has no connection with Rondonópolis, because Rondonópolis is only to take the same cargo in tons for a longer distance. So, at the end of the day starting the operation from Rondonópolis does not change the volumes we move at the port at the end day, as I have mentioned. The RTKs we increase with the same tons we move, so at the end of the day no connection between ramp up of Rondonópolis and port to the end of the year.

Mark Suarez:

Got it. And you mentioned the Brado capital injection of R$400 million; can you explain to me how that came about, how you guys came together with that project, and is there the potential for the same partner to potentially fund the entire R$1 billion for the first five years, or do you think you will need to involve several partners into the mix?

Rodrigo Campos:

Mark, I do not believe we need R$1 billion in equity for Brado, because we have a CAPEX of R$1 billion in five years, you are completely right. But remember that 80% of the CAPEX of Brado is locomotives and railcars, and we have special lines from BNDES called PSI, which are lines with a nominal interest rate all-in around 3% to 4%, nominal interest rate.

So, these R$400 million gives Brado enough equity and leverage capacity to fund all its growth. And more than that, when you look at the cash flow needs of Brado, Brado generates cash flow very fast. As the main CAPEX is railcars and locomotives, you buy railcars and locomotives six months after you are operating. So, there is not a big CAPEX to be done, which will burn cash flow and will be operational only years ahead. In the case of Brado, you buy railcars and locomotives and we start to generate cash from these additional rolling stocks. So, the cash comes back very fast.

Mark Suarez:

OK, great. That was very helpful. Thanks for your time. That is all I have for now.

Stephen Trent, Citi Bank:

Good morning, guys. And thanks for taking my question. I was unable to hear the entire call, as a technical issue, sorry if you have already mentioned this. But there seems to be some local news this morning suggesting that you might be having some discussions with the Government about returning some lower utilization, such as some tracks, and I was wondering if you have any comment on that?

Rodrigo Campos:

Actually, Stephen, the talks are in the very beginning, so nothing here to anticipate. But just to address the point, we are talking here about two specific tracks: one that goes from São Paulo to Rio Grande do Sul state, which represents more or less 5% of our EBITDA, and the Government would like to make a big corridor, one of the projects of the Government is to make a big corridor from the north portion of Brazil, connecting with our rail line in São Paulo, and going all the way to Porto Alegre to Rio Grande do Sul and port of Rio Grande, and this connection passes through our rail line at the end of this day.

So, we are starting discussions. But discussions here are very simple. We have some investments we did and we have the economics of those tracks for ALL, so what we are discussing is to have some indemnization or something equivalent that could have good economics in order to give back those tracks to the Government, otherwise I will just keep my track there. So, this conversation, which I believe is simple like that, we know the economics of those rail lines and we are talking about the Government how we would receive, we will exchange this rail line for an indemnization or to the same economics at the end of the day. So, the discussions can happen or cannot. We are in the very beginning, so nothing to present here, but simple as that.

And there is another track, a very small track in Port of Santos, which is the track which reaches Port of Santos, reaching from MRS as the major, and there is a part which is from ALL, so two concessions. And today, to be frank with you, operation there does not go smoothly, as there are two concessions, there are always operational discussions in order to enter in the Port of Santos, which is bad in terms of productivity. So, giving a small track back to the Government and bringing a new guy, a white-flag guy that would manage this concession could be an operational model that could improve the productivity entering in the Port of Santos. So, this is the mindset of the Government. We believe in that, but different from the line to Rio Grande do Sul, which is a small part of our result, this line Santos, which is a large portion of the volumes we haul. So, we should be very confident on the operational model in order to go to big step of giving back to the Government and having a white-flag guy in the Port of Santos.

So, at the end of day we think the model that the Government is thinking seems to be a very good model, which could bring a lot of gains in productivity, of having just one concession there, a white-flag concession there. But we must be very comfortable with the operational model in order to do this move. So, also as in the case of the track to port of Rio Grande, in Santos also we are in the beginning of the talks, and there is nothing decided. We can go through with that, or we can just keep the rail line as it is. It is a decision we should take and we are starting to talk with the Government.

Stephen Trent:

OK. Thanks, Rodrigo. Very helpful. And just one more question, just in case I missed any comment, I am assuming at this point no updates on what might be occurring with Cosan's conversations with ALL's controlling shareholders?

Rodrigo Campos:

Unfortunately no updates, no news on that.

Stephen Trent:

OK, fair enough. I will leave it at that. Thanks, Rodrigo.

Operator:

I would turn over to Mr. Alexandre Santoro for final considerations. Mr. Alexandre, you may give your final considerations.

Alexandre Santoro:

OK. I want to thank you and say that we talked here a lot about Port of Santos and that we are working hard with our clients and our terminals in Santos to recover the operational capacity. And our operation on Rondonópolis that is remarkable in our history, and it will help us deliver consistent growth as we did in the past and will still continue growing this Company. So, thank you again. If you have any additional questions, please contact us directly. Bye-bye. Thank you.

Operator:

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