Conference Call Transcript — 2Q14 Results — August 6th, 2014

Operator:

Good morning ladies and gentlemen. At this time we would like to welcome everyone to América Latina Logística (ALL)'s 2Q14 earnings conference call. Today with us we have: Alexandre Santoro – 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 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 instructions will be given. Should any participant need assistance during this call, please press *0 to reach the operator. We have simultaneous webcast that may be accessed through ALL's IR website: www.all-logistica.com/ir. The slide presentation may be downloaded from that 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 assumptions 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 conditions, industry conditions and other operating factors could also affect the future of ALL and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I'll turn the conference over to Mr. Rodrigo Campos, CFO and IRO for the Company for a brief explanation on how ALL's figures are presented, and then, Mr. Alexandre Santoro, CEO, who will start the presentation. Mr. Campos, you may begin the conference.

Rodrigo Campos:

Thank you. Thanks everyone for holding the ALL conference call. Just a brief comment before starting the presentation. Just to remember that results from 2013 still have an impact from the operations of ALL Argentina and those results are shown in a separate line called 'Results of Discontinued Operations.'

With that, I would like to transfer to Alexandre Santoro, to start the presentation.

Alexandre Santoro:

Thanks, Rodrigo. This is Alex Santoro. Our quarter could be summarized in four highlights. The first one: the volumes were weaker than expected, in a tough demand scenario and for interruptions in several rail segments due to excessive rainfall. The yields were offset by decreased levels at spot market freight price.

Some good news are that it was our best half year in terms of operational safety and when we talk about the measure with RUMO, the notification of the operation was filed to the antitrust agency here in Brazil.

Going into more details, our rail operations volumes were weaker than initially expected, increasing almost 1% against last year, mainly due to a very tough demand scenario in the quarter, as China abruptly reduced its grain imports from Brazil, affecting transported volumes and yield throughout our rail network.

In addition, excessive rainfall in June 2014 interrupted several rail segments in the Southern region of Brazil, which restrained operations to the port of São Francisco and Paranaguá and interrupted the route from São Paulo to Rio Grande do Sul for about 10 days.

In terms of the rail operations average yields, it grew 4.4% in the 2Q, supported by the tariff set in our take-or-pay agreements, and especially offset by the depressed levels at spot market freight prices.

Spot market freight prices decreased approximately 13% in the wide gauge corridor, from Mato Grosso to Santos, and 21% in the Paraná corridor, which are the two most important corridors we operate.

With prices in our contracts running above spot market prices, a large portion of our clients decided to operate on the inferior limits of our agreements, which usually represents 90% of contracted volumes.

The consolidated EBITDA grew 0.2%, reaching almost R$508 million, as the result of a flat performance in our rail operations and an increase of 5% in Brado Logística EBITDA and a decrease of 51% in Ritmo Logística's EBITDA.

Brado continued its ramp-up in the second quarter and presented a volume growth of 18%, reaching 18.6 thousand transported containers. That growth was mainly driven by the wide gauge and Paraná corridors, where the company added volume stocks for 2014 and where the major part of investments is concentrated.

Ritmo Logística had another tough quarter as volumes decreased 30% in the 2Q and EBITDA grew up to 51%, to R$3.4 million, pushed by both intermodal business units and the dedicated solutions unit.

Moving forward to the next slide – slide number 5 – the net revenues increased 4.1% when compared to the second quarter, reaching R$1.76 billion. In the first half of the year, the net revenues grew almost 6% and achieved R$1.9 billion in the first half.

Our consolidated EBITDA reached R$579 million, a flat growth in the 2Q14 against 2Q13. Our rail operations contributed with a 0.9% EBITDA growth, and Brado posted an

improvement of almost 40% year-over-year in this field, while Ritmo Logística's EBITDA partially offset it. Our consolidated net income was about R$93.8 million in 2Q against a negative R$74.4 million year-over-year.

Now I would like to pass to Rodrigo, who will discuss the results of our business units Brado and Ritmo, as well as the financial consolidated highlights. Thank you.

Rodrigo Campos:

Thank you, Santoro. Moving to slide 6, where we will discuss results for rail operations, we see that volumes in the 2Q14 increased 0.9% as compared to 2Q13, mainly driven by an increase of 4.6% in industrial volumes, partially offset by a decrease of 0.1% in agricultural commodities. In 1H14, volume grew 1% as compared to the same period of last year.

When we go to net revenues, net revenues increased 5.4% in 2Q with a 4.4% yield growth in rail operations. And EBITDA was mainly in line with the EBIDTA we had in 2Q13 reaching R$560 million.

When we go to agricultural commodities, as Santoro said, volumes were pretty much in line with the same period last year and, of course, we expected and were prepared to go further than that – we expected a better quarter in terms of volume growth. But the volumes in the 2Q were impacted by import reductions from China.

China, at the end of April, cancelled some vessels which were expected to dock in the port of Santos and in the port of Paranaguá in May and June, so China imports impacted exports in May and in June; but, actually, it has already affected transportation of agricultural commodities since April.

So, it reduced the demand and also impacted spot market freight prices. When we look at the spot market freight prices in the wide gauge system, which goes from Mato Grosso to Santos, the prices were 13% below those of last year. And when we look at the Paraná corridor, from Londrina and Maringá to Paranaguá port and to São Francisco, freight prices went down 21% as compared to last year.

So, there were important price drops in our main corridors. With that, the clients also went to the minimum volumes of the contracts. The margins we have in our agreement went to the minimum volume of our take-or-pay agreement, so at the end of the day it also impacted our volumes.

And, in the end, in the South of Brazil we also suffered with a lot of rain in June, specifically. Some cities in Rio Grande do Sul, Santa Catarina and Paraná were impacted – they were isolated for some time. And in terms of our rail operations we faced several restrictions and at some points even some interruptions of our operations during June in the South of Brazil.

So, in the end, I'm going to slide eight. We see that our net revenues grew 5.7% in agricultural commodities as compared to 2Q13, and our EBITDA was basically in line – it increased 0.4% as compared to 2Q13, reaching R$473 million, and with a yield growth of 5.8% – a little bit lower than inflation in agricultural commodities.

When we go to industrial products, which are shown in slide nine, volumes increased 4.6% as I mentioned, in the 2Q – basically in two segments: containers, in which volumes increased 25% and it is very much related to our Brado operations; and in wood and paper products, in which volumes grew 29%, so these are the segments which support the volume growth in industrial segments.

When we go to page 10, we see that net revenues of industrial products increased 4% in the 2Q14 as compared to the 2Q13, with a yield decrease of 0.5%, which is basically explained by the change in needs of transported volumes, with an increase in Brado, in terms of containers, and an increase in wood and paper at the end of the day. And the EBITDA margin decreased, as compared to the 2Q13, from R$89 million to R$88 million in the quarter.

When we go to Brado – page 11 – we see that Brado had a very good quarter in terms of volume growth. The number of containers transported increased 18%. When we consider RTKs, which considers also the distance transported, the volume, as I mentioned, increased 25% – so good volume growth. And the volume growth was very concentrated in two corridors – the Paraná corridor, where volume grew 37%; and in the wide gauge corridor, from Mato Grosso to Santos, where volumes increased 36%.

And those are the corridors that Brado concentrated its investments in additional rolling stock for this year, and also in terms of terminals.

Remember that in the wide gauge system Brado has a new terminal, in Rondonópolis, and also Brado has expanded its terminal in Cubatão, near Santos, to prepare to this year's growth. And in the Paraná corridor, Brado also expanded the terminal in Cambé, so at the end of the day it is very in line with Brado's plan when we see this year.

And EBITDA grew 40% in 2Q14, from R$11 million to R$15.5 million, and if we consider the whole year, in 1H14 Brado's EBITDA is growing at 40% compared to last year.

When we go to slide 12, which gives details on Ritmo Logística's results, we see that Ritmo did not have a good quarter. They had a very tough quarter explained by an important reduction in volume – a 34% reduction in volume – which is partly related to the dedicated solutions segment, in which we have operations customized to specific clients, and here we left some operations, given that those operations did not reach our standards of return.

And also, there was an important reduction in the volumes of intermodal operations – very much impacted by the reduction of demand we mentioned, in the 2Q, and also by the reduction in spot market prices, and the trucking business is a business in which margins are small and with that reduction in spot market prices it also impacted Ritmo. So, at the end of the day Ritmo's EBITDA decreased from R$7.1 million in 2Q13 to R$3.4 million in 2Q14.

Going to slide 13, we see that consolidated revenues increased 5.9% in the 1H14. Consolidated EBITDA, which is shown in slide 14, increased 4.8% in the 1H, reaching R$1.2 billion, with an EBITDA margin of 52%. And net income, which is shown in slide 15, increased from R$40 million negative to R$100 million positive. Remember that last year we had the impact of operations of ALL Argentina, which explains, in large part, that net income increase.

And when we look at the net debt vs. EBITDA ratio, shown in slide 16, we see that we ended the 1H14 with a net debt EBITDA ratio at a little under 2.4x the EBITDA.

With that I would like to pass the floor to Alexandre Santoro.

Alexandre Santoro:

Thanks, Rodrigo. Just some quick additional comments on the quarter results and on our expectations for the next quarters: the perspectives should improve for the 2H as grain exports should recover to its normal course and sugar volumes are expected to increase through Paranaguá port.

Moreover, we have a better operational scenario than the registered last year, as the unloading restrictions we had at the main grain unloading terminals in Santos were already fixed and are operating at capacity since the beginning of the year.

In spite of that, the 2Q crop is expected to decrease its production area year over year. When we compare it to 3Q, we do not have the capacity to load in Rondonópolis the major part of the agricultural commodities volume that we used to load at Alto Araguaia terminal, increasing average transported distances.

And as I said before, we had our best half year in terms of operational safety. And that is the most important operational KPI, and it shows us that we are operationally ready to perform a better 3Q.

And the last thing, talking about the merger with Rumo, in April 15 and May 18, our board of directors and ALL shareholders approved, respectively, the proposal sent by Rumo Logística aiming at combining our operations with theirs through the merger of ALL's shares in to Rumo. The merger is still conditional to previous approval by the Brazilian antitrust authority and the National Land Transportation Agency, as well as other precedent conditions.

The notification of the operation in CADE – the antitrust agency – was filed in July and now follows the usual procedure of approval. If all those conditions are achieved, ALL shareholders will own 63.5% of the new company's shares after the completion of the measure.

With that I conclude our presentation and put ourselves available for clearing up any doubts you may have. Thank you.

Mark Suarez, Euro Pacific Capital:

Good morning, guys and thanks for taking my questions here. I just need, maybe, to go back and talk about your volume mix. Looking forward, given your announced merger with Rumo, should we start thinking about sugar volumes now becoming a large part of your business in terms of both revenues and railway capacity to the Port of Santos?

Rodrigo Campos:

Mark, I believe that it is natural to expect sugar volumes to expand. Remember that we did that project with Rumo exactly expecting that. We have a duplication that will be completed in March, which will increase a lot the capacity of the system. And specifically in this quarter, the mix of sugar and soybeans increased a lot in favor of sugar, also because we did not grow as expected in soybeans, because of the demand problems we had. So I would say that it is natural to expect a growth in sugar but also in soybeans and grain, specifically – soybeans and corn. And specifically this quarter we did not grow as expected in soybean and corn.

Mark Suarez:

And do you have a target range or an estimate of how much that will be as a proportion of total revenues? That is sugar I mean.

Rodrigo Campos:

No, actually, we have a big potential of growth of sugar in the state of Sao Paulo. There is a big demand there, which should be transported by the trucks to the port, so the potential of growth in sugar is big. We have a much smaller market share in sugar, if you compare with grains, it is an important potential of growth, depending on quarter and on the operational conditions, on rail and ports, it depends on a lot of things.

On the long term, of course we have a smaller market share in sugar than we have in the grains, but we still have a big potential in both segments.

Mark Suarez:

You also mentioned, and we know from past discussions that obviously sugar has a shorter haul transportation than soybeans, for example, on average, as you go from Mato Grosso to the Port of Santos, as opposed to the inner São Paulo to the Port.

Can you give us a sense of the margin difference between a car load of sugar, vis-à-vis soybeans? Is there a number you can give us in terms of EBITDA so that we have a better sense of what the margin difference is between these two commodities?

Rodrigo Campos:

I do not have this exact number here, but there is a natural difference in margin always, because of the distance, we have a higher distance in Mato Grosso than we have in the State of São Paulo. So, probably a 5% to 10% difference depending on the origin and depending on the route, more or less, ranging from 5% to 10% margin.

Mark Suarez:

OK, that is very helpful. Finally, on the agricultural volumes as we are going to the 3Q, you mentioned you expect to see an improvement. How should we think about corn volumes and also premiums coming up, do you feel that maybe those volumes could be stronger than what we would typically see in the 3Q over the past five, six years? You feel that could be stronger than seasonally normal, this year versus last year? What are your thoughts on that?

Rodrigo Campos:

When we look to the corn crop, specifically the 2Q corn crop, the last two years we had a very strong 2Q crop, which was good and we still expect a very huge corn crop in the South of Brazil, in Paraná, Rio Grande and in Mato Grosso we expect a second corn crop lower than last year, but still a very good corn crop if you look historically.

Also, I mean, we should have more soy meal throughout the year, because this year, with all of these points we mentioned about China, and also because of the price of a agriculture, of grains in the external market, the traders decided to crush much more soybeans than if you compare with last year, for example.

When we look to the mix of this year, you should see more exports of soybean meal and less exports of soybean grains. So, the mix should change, which, from a point of view, the soybean meal the exports grow throughout the year instead of a peak on the harvest season, so that is a positive trend also.

Mark Suarez:

That is great, great color you have provided. Just to follow up on that, for my last question, you talked about Ritmo, you talked about intermodal volumes going down because of a decrease in agricultural volumes, should we expect maybe a rebound in Ritmo in the 3Q, if you have a strong quarter volume mostly correlated to soybeans? What commodity drives that?

Rodrigo Campos:

Yes, in the intermodal segment, yes, once the exports market for price recovered, once the intermodal market recovers, we expect an improvement in the intermodal segment. In the dedicated solution segment, we really some operations, of course we are looking for another one, but we are very disciplined in our return targets to get new operations. In this case, in solutions, you have a reduction on volumes, as compared to last year.

Mark Suarez:

OK, that is great. I will get back in the queue. Thanks for your time.

Kevin, Citigroup:

Thank you for the time. Most of my questions were answered, I just had a quick question, I do not know whether you mentioned during the call, but is there any update on when you expect the operations to normalize following last years' accident fire? Have they normalized or do you expect them to normalize on the 3Q or 4Q?

Rodrigo Campos:

Remember that last year we had some important problems on the grain terminals at the Port, so PGG, which is the most important terminal for rail and loading was partially non-operational because of a fire that we had last year, and also the Terminal 39, which is the second most important, was affected by a ship which hit its ship loaders.

So, at the end of the day, when we compare this year with next year, the port scenarios are much better. We improved a lot as compared to last year. So, we have all the grains terminal working at full capacity.

I am not sure if you are talking also about the fire in the sugar terminal, which happened recently in the Port of Santos, but it was a very small one. It affected more one terminal and more on the trucking operations, the unloading trucking operations, so it will not have any material impact in our operations.

So, the port scenario should be much better than the scenario we faced last year.

Kevin:

OK, understood. So, I just wanted to confirm that basically all the problems from last year basically worked out. The big question is on the merger, you have already given us a pretty helpful update, I was just wondering whether you have any kind of timeline or expectation for approval from CADE and ANTT.

Rodrigo Campos:

We do not have a timeline, of course we are doing everything which is possible to do, soon as possible, at the end of the day. What we did was file the operation as CADE. CADE has a legal term that they can analyze, the process, which is the legal limit, 330 days, but we are providing all the information, we are being very proactive, giving CADE the information in order for it to make its analysis at a much smaller time than that.

So, I cannot anticipate the time, but I can tell you we are doing everything which is in our hands to have all the approvals in the short term.

Kevin:

OK, thank you. You think CADE is going to be the bottleneck, I guess, their approval?

Rodrigo Campos:

Yes, I believe so.

Kevin:

OK, thank you very much.

Ravi Jain, HSBC:

Good morning. I just wanted to kind of get an idea of how you are seeing the exports prices now in July and what are the expectations for the total in the 4Q? Are you seeing clients getting more normalized in their volumes since they are going for the minimum volume in their agreements or is it already more normalized in the month of July?

My second question regards CAPEX. The 1H has been pretty strong on the CAPEX front, so what is your overall 2014 expectation now for CAPEX this year?

Rodrigo Campos:

In terms of freight prices, I would say freight prices recovery, as compared to the 2Q, but I still wonder on our take or pay agreements, more or less. In terms of CAPEX, we still have the expectation of R$800 million when we consider ALL for operations, of course, without considering on that, the CAPEX related to the duplication from Campinas to Santos, which is a CAPEX related to our agreement with Rumo.

Ravi Jain:

Perfect, thank you.

Mark Suarez, Euro Pacific Capital:

Hello, thanks for taking my questions again. I do not know whether you mentioned this in the call, I do not believe I heard it, but in terms of the duplication here, I know you have the operational license now, when do you expect to complete that double track project and have your CAPEX budget changed at all from last quarter?

Rodrigo Campos:

We expect to have the duplication of operational in April next year.

Mark Suarez:

And is your CAPEX budget towards that duplication the same as last quarter?

Rodrigo Campos:

Yes.

Mark Suarez:

OK. Finally, on the capacity expansion on the sugar terminals, I know you have alluded to the fact that maybe that could be expanded, is there any progress there, any updates you can give regarding that fund?

Rodrigo Campos:

The operation in sugar ports are improving. Of course, the increase of volume of sugars reflect these improvements.

Mark Suarez:

OK, that is all I have for now. Thanks again.

Ravi Jain, HSBC:

Hello, thank you. I just have one final follow up question, basically, on the financial expenses, aligned with your income statement. Of course, there has been an increase versus last year and the last few quarters, is there any other reason apart from the higher interest rates and higher debts?

I am looking more particularly on whether there has been more or less expenses that you were paying to Rumo, and now that the litigation has ended, should we expect lower financial expenses or should it remain at these high levels in the next few quarters?

Rodrigo Campos:

Part of this increase was related to interest expenses, and part of these increases, compared to last quarter, were related to Rumo operations. We had R$30 million increase related to a higher interest provisions related to Rumo operations.

We remember that the accounting of Rumo, part goes on the costs, rent of rolling stock, part of the account is accounted like a financial, you increase your PPEs, and you have a debt, which passes through the interest expenses. So, there was an increase related to the Rumo operations. Of course, we are on the crop season now, in sugar, which the demand in the 2Q was higher than in the 1Q, so you have more interest expenses.

Until we have the final CADE decisions, both companies keep operating in separate companies, so the accounting of interest will depend on the demand of sugar quarter by quarter, at the end of the day. So, you do not operate as a consolidated Company until CADE approves.

Ravi Jain:

Got it, thank you. That is helpful.

Operator:

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

Alexandre Santoro:

I just want to thank you all for participating on this conference call. Have a great day, thank you.

Operator:

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

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