Conference Call Transcript — 3Q14 Results — November 5th, 2014

Operator:

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to America Latina Logistica, ALL, 3Q14 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 a listen-only mode during the Company's presentation. After ALL's remarks are completed, there will be a question-and-answer session. Should you need any assistance during this call, please press *0 to reach an 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 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 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 condition, 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 will turn the conference over to Mr. Alexandre Santoro, CEO, who will start the presentation. Mr. Alexandre, you may begin the conference.

Alexandre Santoro:

Good morning. This is Alex Santoro speaking. Thanks for joining us at this conference call. To start our presentation, I would like to mention a few important highlights in this 3Q for our Company. The volume has improved 4.4% even in a tough demand scenario, reaching 12.5 billion RTKs, our record in a quarter.

Yields grew 3.1% supported by the tariffs in our take-or-pay agreements, even in a depressed level at the spot market for its price. In terms of the merger with Rumo, today we have two new facts, the antitrust agency determine that the operation as complex in order to perform deepen analysis of the competitive conditions in the relevant market and request some questions about the regulation in market data to the National Land Transportation Agency, the ANTT.

At the same time, the ANTT approved the merger today without restrictions. This is really good news and an important step to the conclusion of this merger.

Now, going further in more detail, we can see on slide number three that in the 3Q our rail operations volumes grew 4.4%, reaching 12.5 billion RTK.

Despite a better operational scenario at Port of Santos when compared to last year, we faced a very tough demand scenario in the quarter, as the great corn production in United States reduced Brazilian exports depressing abruptly spot market freight price in the most important agricultural corridors that we operate.

The rail operations average yield grew 3.1% in the 3Q year over year, supported by the tariffs set in our take-or-pay agreement, and partially offset by the depressed levels at the spot market freight price.

Spot market freight price decreased approximately 25% in the Wide Gauge Corridor from Mato Grosso to Santos and more than 13% in some origins in Parana corridor, which are the two most important corridors that we operate.

However, since most of our volumes are take-or-pay contracts, we did not observe the drop in our consolidated rail yields.

The consolidated EBITDA reached more than R$500 million, increasing almost 10% against the 3Q13 with a contribution of R$483 million from the rail operation, almost R$20 million from Brado's EBITDA and R$5 million from Ritmo.

Brado had another great quarter, continuing its operational ramp up in the period. Brado presented a volume growth of almost 18%, reaching 21,000 containers handled. This growth was driven by the augment in the wide gauge corridor in Parana, where the Company added rolling stocks for 2014 and where the major part of investments is concentrated.

Ritmo Logistica did not have a good quarter, as volumes decreased 32% in 3Q year over year, and EBITDA dropped 28% to R$5.3 million, pressured by both intermodal business unit and dedicated solutions unit.

Moving to the next slide, number four, we can see our consolidated results. Our net revenue has increased 5.2% when compared to the 3Q, reaching almost R$1 billion. In the 9M14, the net revenues grew 5.7% and achieved R$2.9 billion during the 9M14.

Our consolidated EBITDA reached R$508 million, increasing almost 1% in the 3Q, against the 3Q13. Our rail operation contributed 0.6% EBITDA growth and Brado posted an improvement of 23.5% year over year, while Ritmo Logistica's EBITDA partially offset it. Our consolidated net income was R$37.6 million in the 3Q and in the 9M it reached R$138 million, against R$44 million in the same period of last year.

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

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Rodrigo Campos:

Thank you, Santoro. Good morning. Starting from rail operations, as Santoro mentioned, volumes increased 4.4%. And when we breakdown in the main business units, agricultural commodities increased 5.2% in terms of volumes and industrial products volumes increased 2%.

When we look to net revenues, net revenues increased 8% and with average yield increase of 3%, which is below the inflation, but is a positive number and it was supported basically by our take-or-pay agreements, as the spot market freight price in the quarter was below last year's freight prices.

In terms of EBITDA, EBITDA grew marginally from R$480 million to some R$483 million on the quarter and in the year EBITDA, in nine months has increased 3.3% as compared to the same period of last year.

Going into the agricultural commodity business in slide seven, we see that we have 5.2% of volumes even in a very weak demand scenario. It reflects basically market share gains in corn transportation, in exports, we know that the exports went down double digits, so material market share gains.

Also the government did some auctions to increase price for exporters. It is like a – they call that auction PEPRO Auctions and it is a kind of export incentives, which avoid an even tougher demand scenario in the quarter.

Also we increased the transport of soybean meal. Remember that the soybean crop this year was more – the inventories were high and you have more soybean crushed this year than if you compare with 2013. So, we have all of these soybean meal volumes in the 3Q and this is the volume that we expect also to increase in the 4Q.

And finally, we have a quarter with a full contribution of Rondonópolis. If you go into last year in the same period, Rondonópolis was already operational, but was not operating at full capacity, so also a positive contribution.

When we go to slide eight, we see that agricultural commodity revenues, net revenues increased 8%, with an increase in average yield of 2.6%, also below inflation, but much better than the scenario we saw in spot market freight prices and basically supported by our take-or-pay agreements.

The EBITDA increased 2% from R$390 million to R$397 million in the quarter and in the 9M EBITDA increased 3.6% in 2014 as compared to 2013. When we go to industrial products business unit, volume increased 2%, mainly driven by a 9.5% growth in the intermodal unit.

And there were two segments which were the main drivers of this growth. The first one is wood products, which increased 14% and containers, which increased 21%. Those segments have been increasing at material rate along the year. If you see in the 9M wood products increased more than 40% and containers increased more than 20% volume wise.

In Pure Rail flows, the volumes decreased in the quarter 4.2% and basically pushed by the ethanol exports in Brazil, which went down more than 70% in the quarter. It is also related with very big corn crop in the United States, which increased also ethanol production in the country and impacted Brazilian ethanol exports at the end of the day. In the year, the Pure Rail flows are more or like in line with the same period of last year.

In terms of net revenues in slide ten, industrial products increased 2% in the quarter, with an average yield growth of 4.6%, a little bit better than agricultural commodity, but still below inflation. And EBITDA went down 5.2%. We had an increase in volumes, but I mean with an increase in yield below inflation and with a different mix of transported volumes, EBITDA had a reduction as compared with last year. If you take the 9M numbers, EBITDA is growing 1.8% as compared with the same period of last year.

Brado volumes grew 24.5% if you measure in terms of number of containers transported, also more than 20% if you measure in terms of RTKs in the quarter, so material growth rate for Brado. In the year, in the 9M, Brado also is growing very close to 20%, volume wise.

And the main corridors that Brado is growing are Wide Gauge corridor, which grew almost 45% during the quarter and Parana corridor where Brado grew 50% during the quarter. Those are the corridors where Brado added additional rolling stock also in two terminals, so those are the corridors where Brado concentrated its investments for 2014.

And in terms of EBITDA, Brado grew 23% in EBITDA reaching R$19 million on the quarter and reaching almost R$50 million accumulated in the 9M14.

When we go to slide 12, we see that our subsidiary Ritmo had another tough quarter volume wise. Volume went down like 32% and it is a result of some of the discontinuation of some operations in dedicated operation business unit given the new prices set on these units, we will prefer to discontinue those operations. And also because of the intermodal business unit, where the scenario were very similar, the scenario we mentioned here for agricultural commodity transportation, lower volumes and also very pressured prices on the spot market.

So at the end of the day, volumes went down and Ritmo faced a difficult environment in terms of pricing as well. Ritmo's EBITDA decreased 28% in the 3Q, as compared to 3Q13 and even in 9M the reduction is 35% EBITDA as compared with last year.

Moving to page 13, we see that our revenues increased, the consolidated revenues increased 5.7%, EBITDA grew 3.5% with EBITDA margin going from 53% to 52%. The net income, consolidated net income increased from R$44 million to R$139 million, a material increase. But remember that the low base of comparison of 2013, because we had the discontinuation of ALL Argentina, which had an impact in 2013 results.

And when we go to the capital structure, net financial debt/EBITDA, we see that our net debt/EBITDA ratio increased from 2.2 to 2.45 in 9M14.

With that, I would like to pass the word to Santoro to do some additional comments.

Alexandre Santoro:

Thanks, Rodrigo. Just some quick additional comments on the quarterly growth and our expectation for the next quarters. For the 4Q, it is still early to anticipate condition for commodities demand. We believe that the market will be similar to the 3Q.

For industrial products, we expect a heavier scenario of ethanol exports and a positive contribution of Brado and the total volumes. Our rail operations' CAPEX will get over our original guidance of R$800 million in 2014 and should be between R$900 million and R$950 million in this year, reflecting our extraordinary investments in addition to recurrent organic CAPEX.

In terms of the merger with Rumo, we will continue contributing and working together to the antitrust agency aiming to obtaining approval for the merger proposed as soon as possible. And, again, the approval from the National Land Transportation Agency is a very important step to conclude this merger process.

With this, I conclude our presentation and put ourselves available for clarifying any doubts that you may have, and thank you very much.

Ravi Jain, HSBC:

Good morning. I had a quick question on the spot yields. How do you see the spot yields in 2015 given that they were pretty weak this year? And secondly, can you remind us approximately how much percentage of your revenues are spot versus the contracted yields, please?

Rodrigo Campos:

Hi, Ravi. Good morning. When we look to next year, our negotiation process with clients normally start – normally around November and goes until February, which was the period where the crop, the planted area starts to be more clear here in Brazil. So, that is the time of the year we start to negotiate prices for next year.

When we negotiate prices, we are of course looking forward, looking to the prices, to expected freight prices for the next year, which is always a function of the size of the crop and things like that.

When we look to 2014, it is true that spot prices were below our take-or-pay agreement, but if you come back to 2013, spot prices were higher than our take-or-pay agreements on average. So, this is part of the game.

I believe that when we start to negotiate next year, everybody will be looking to the next year, and it is too early to make projections about crop in Brazil, crop in United States, because at the end of the day it depends on planted area and climate.

But it is very hard to imagine an environment like you had this year with sizable crop, record crop in both countries as we saw this year.

So I believe it is another discussion, another negotiation and every year we are either below the agreement or above the agreement, so it is part of the game.

Ravi Jain:

Perfect. Thank you. And my second question was on the storage capacity that the farmers are using right now to maintain their crops, and as you mentioned they could be pressured to open that up because of the 2015 harvest season. By then, do you expect, first, to see this impact in terms of the farmers will be forced to do start selling up whatever they had stored for the current harvest year? Will that be by the first quarter of next year when you start harvesting the next crop?

Rodrigo Campos:

Yes. I believe this year we should have a big end of the year inventories. I mean, once there is a big agricultural commodity inventories on the countryside today and you know that when the next harvest begins, the storage capacity should be prepared, should be open to receive this new storage.

So at the end of the day, at some points these volumes should be exported and probably we should have our 1Q next year with more volumes, which is not typical, normally the 1Q is a low season for volumes.

Ravi Jain:

Perfect. Thank you. Thank you for that.

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Mark Suarez, Euro Pacific Capital:

Good morning, Alex and Rodrigo. Just to go back to your comments on the agricultural volumes. Can you give us a sense as how those volumes are tracking right now into October? And how should we think about corn volumes and ethanol traffic as we head into 4Q, as you have this lower export traffic coming out of Brazil, obviously due to the United States and Canada's corn crop?

And I am just wondering if you expect those export incentives by the government to continue and to maybe partially offset some of that decrease, if you will?

Rodrigo Campos:

Yes, actually there were some PEPRO Auctions in the 3Q that should support exports in the 4Q, but the scenario until now is very similar with the scenario we saw in the 3Q. But at the end of the day, it is hard to anticipate the next two months of the quarter and also 1Q next year because you have important inventories on the country side, you have some pressure to open the space for the new harvest.

So, the dynamics of exports is not easy to anticipate in the next four months, let us put it that way. But some pressure in some point we will see, because surely you must have the country prepared to receive the new crop in the mid of February and the beginning of March.

Mark Suarez:

Okay. And so with that do you think that may we should start thinking about pricing, tracking below the inflation target as we head into 2015, you think there is maybe a bigger risk that assuring you those contracts that you have less leverage to push up those prices to the level that we saw in 2013?

Rodrigo Campos:

When we look 4Q, the freight-price scenario didn't change at least until now. I mean it is a scenario similar to 3Q. For the next year, it is a completely different environment we are looking forward. We are looking completely to 2015 and it will depend on expectations of the crop, the fact that we will have a higher inventory at the end of the year tends to be a positive pressure on prices at the end of the day. So it is a completely new discussion. I would not say that I expect price below the inflation for next year, but I mean it is too early to talk.

Mark Suarez:

OK. And then the third question on the CAPEX, I noticed you have raised your guidance, I am wondering what the difference is toward those investments and going towards. And maybe you can clarify what the difference is between the new guidance and the previous R$800 million level?

Rodrigo Campos:

Actually, Mark, we took some investment decisions here of doing some extraordinary CAPEX as compared with our original plan. Basically, three different things. One is some CAPEX that we are doing within the Port of Santos. This year, Port of Santos is not too much pressured, it's not very pressured because of the low demand, but you know that we are duplicating the way from Campinas to Santos, and it should start to be operational in April next year.

So, we expect a very different demand scenario, we will have more capacity also, so at the end of the day we decided to improve facilities inside the Port of Santos in order to be better prepared to capture in the next year those additional volumes.

The second important investment plan was related with the urban areas, the rail networks which cross urban areas and we are doing some CAPEX of improving the tracks on urban areas, we know that these areas are very sensitive in terms of safety, you are all the time crossing with people with and cars in roads, in streets. And this is also important in order for us to keep some good speed in urban areas. So, this is a project for 2014 and there is a part for 2015 also.

And the third one is our complex in Rondonópolis, which we are also doing some improvements on the facilities, also looking forward for the Wide Gauge Corridor for the duplication, for the additional volumes that it should bring to the system when duplication is completed.

Mark Suarez:

OK. So is the rail duplication investment including the new guidance here?

Rodrigo Campos:

No, this is part of our agreement with Rumo. So it is in a separate way.

Mark Suarez:

OK. And then finally, obviously you know you had the ANTT made a decision on the transaction, which was positive. And so, I am wondering should we expect a faster turnaround now from CADE given the decision by ANTT or how should we think about the timeline with regards to the merger here?

Rodrigo Campos:

I believe that, of course the ANTT is the regulator and if someone that CADE heard and has important weight on -- to understand the regulatory environment, the aspects of rail operation, but I mean, the CADE by the end of the day is a separate process and we are keeping contributing with CADE with more information, with all the information they ask, because we are pretty sure that, at the end of the day, this merger will create more capacity, will increase efficiencies and we will eliminate bottlenecks for all users of the railroad. So, this is what we are trying to show to CADE, which is what we believe at the end of the day.

Mark Suarez:

OK. That is fair enough. That is what I have now, guys. Thanks for your time.

Rodrigo Campos:

Thank you.

Stephen Trent, Citi:

Good morning, Santoro and Rodrigo. Thanks for taking my question. Just one or two from me. Looking at kind of a repeat of the question on yields looking into next year, has your thinking changed at all on yields with respect to the potential for Petrobras to increase diesel prices? And in your forecast, are you making any assumptions about Petrobras moving the needle on diesel price?

Rodrigo Campos:

Stephen, normally what we do is we set prices or negotiate prices assuming the same price of the diesel and our contract has an automatic pass through of the diesel on 30% to 40% of the diesel price increase.

So, if the diesel price increase more than inflation, it is additional tariff growth, if it is below the inflation, it is pushed down. So at the end of the day normally our negotiations to next year prices consider the same price of diesel with an automatic pass through.

Stephen Trent:

OK, Rodrigo. Thanks very much. That is very helpful. And just one more question. I couldn't hear you too well when you mentioned the 4Q, you said something about higher ethanol exports if I'm not mistaken. I'm wondering if I could trouble you to repeat that comment.

Rodrigo Campos:

No, actually in terms of ethanol, I mean during this crop season I believe we have no change in scenario, more or less the same scenario, the same exports. And of course, for next year this is another thing, but for this year the ethanol export should be below 4Q last year.

Stephen Trent:

OK. That is very helpful. That was all from me. Thanks very much.

Rodrigo Campos:

Thank you, Stephan.

Ravi Jain, HSBC:

Thank you for the follow-up. One last question I had was, once you complete the duplication between Campinas and the Port of Santos and your additional CAPEX from Rondonópolis, so with the additional capacity do you think that could put a slight pressure on your yield negotiations, because if you wanted a higher volumes do you think that could put some slight pressure on the yields?

Rodrigo Campos:

Actually, Ravi, when we look through 2013, which is a more typical year than 2014, we -- all the time we faced excess demand, more demand that we could attend because of our capacity, because of Port capacity, because of several supply restrictions that avoid us to transport all the demand. So, we had more demand on agreements than at the end of the day we could attend.

And this was the case for the last three or four years. And this year is an exception with a very low demand. So in a more normal scenario, and remember that the crop in Brazil was not bad, the crop in Brazil was a good crop. And when we go into next year, probably we should have a high end-of-the-year inventories, we should have another crop and probably, I cannot anticipate that, but this scenario of big crops in Brazil and in the United States normally do not happen very frequently. So in a more normal scenario, I mean, we should start to see the same excess problems that we always had, more demand than capacity.

So, I believe that the price, the spot price, the freight price negotiations will be very based on next year expectations and it is early to say because we don't have the planted area, we don't have too much information on that, we will have more on that in the next two months, but, I mean, the expectations to pass through inflation at this point, something like that.

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Ravi Jain:

That is helpful. Thank you so much.

Operator:

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

Alexandre Santoro:

Ok. I just want to thank you all for participating on this conference call, and wish you all a great day. Thank you very much. Bye.

Operator:

Thank you. This concludes today's ALL's Earnings Conference Call. You may disconnect your line at this time.


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brado
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