Conference Call Transcript — 4Q14 Results — April 1, 2015

Operator:

Good afternoon, ladies and gentlemen. At this time, we would like to welcome everyone to America Latina Logistica 2014 Results Conference Call. Today with us, we have Mr. José 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 America Latina Logística's remarks, there will be a question-and-answer session for industry analysts. At that time, further instructions will be given. Should any participant need assistance during this call, please press *0 to reach the operator. The audio and slide show of this presentation are available through live webcast at www.all-logistica.com.br/ri. 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 and Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of America Latina Logística's management, and on information currently available to the Company. They involve risks, uncertainties and assumptions because they relate to future events and therefore depend on circumstances that may or may not occur in the future.

Investors should understand that general economic condition, industry condition and other operating factors could also affect the future results of America Latina Logística and could cause results to differ materially from both expressed in such forward-looking statements.

Now, I will turn the conference over to Mr. José Cezario. Sir, you may now begin your conference.

José Cezario Menezes de Barros Sobrinho:

Good afternoon, everyone, and thank you for joining us for ALL conference call, where we will discuss the results that were just released relating to the fiscal year ended on December 31st, 2014. Starting the presentation from slide three, as previously announced at the end of 2014, we decided to end the Vetria Mineração project and to sell our stake at Ritmo Logistica which will operate the truck logistics.

Regarding Vetria, the decision was taken due to the non-fulfillment of certain conditions stipulated in the contract, but also especially due to the current outlook and conditions related to the price charged for iron ore on international market. In both cases, we believe that as we leave these businesses, we will be able to focus on the business that is really a priority for us, the railway cargo business.

As a result of these decisions, all the results of these two businesses were treated for accounting purpose, including retroactively as discontinued business in the income statements and in the balance sheet were also segregated and treated as assets or liabilities available for sale.

For this reason, the presentation presents only two businesses to be reported and discussed, the ALL railway operations and Brado, which is our investment in the container logistic business, in which we currently own a 62.2% stake.

It is worth mentioning that in the future, after the measure with Rumo, we will have the railway and port businesses sub-divided in the corridors of wide gauge and narrow gauge. Wide gauge represents the North and Paulista track, plus the port of Santos, and the narrow gauge presents the South and West track.

Moving on to slide four. 2014 was not a good year for ALL in terms of consolidated results, EBITDA was R$1.1 billion, 32% lower than 2013, a reduction of approximately R$570 million, partially due to operational impact related to the market dynamics that we will further detail when we talk about the market scenario, and also because of several extraordinary expenses and costs that negatively contributed to this result in 2014.

This was to some extent explained in the earnings release that we disclosed last night, along with the financial statement, but we will discuss it in more detail in this conference call. The 3.3% increase in volume in RTK in the year was not enough to offset the aforementioned impact.

Another important issue that happened at the year end and reflected negatively on the year's result was the adjustment for impairment of assets that was recorded in 2014, which totaled R$1.1 billion. This effect does not affect EBITDA, as it has a nature debt which maturely reflects the depreciation or amortization, but it impacts largely on the reported net income. In addition, as part of this revision of processes in accounting practices that the transition team worked on, we also felt the need to change some accounting practices that ended up creating the need for adjustments in previous years. We will give more detail about these later on.

Another relevant subject to be pointed out was ALL's non-compliance with financial covenants, which happened at the end of 2014 as disclosed in the material fact yesterday. We already asked for and received from the main creditors of the Company a waiver to solve this breach and we are in advanced process of finalizing the negotiations with these creditors to bring the maximum leverage levels of ALL back to a level that is consistent with the Company's current situation, taking into consideration the new accounting practices and the new investments which we believe are necessary for the turnaround we want to perform in this business.

Lastly, I would like to highlight that the merger with Rumo happened officially today, when the exchange of ALL shares for new shares issued by Rumo was held and such shares started trading on the Bovespa market under the ticker RUMO3 today.

Let us now move on to the next slide, number five. I would like to discuss ALL's consolidated numbers. First of all, our consolidated net revenues went up by 6.6% in the year with an increase recorded in both the rail operations by 6%, and in Brado, by 4%. The EBITDA, as I mentioned, presented a significant reduction in 2014, from R$1.6 billion to R$1.1 billion, a reduction of 35% due to the effect of the change in accounting in the Rumo contract, in addition to other impact on costs.

Although some of them are non-recurring or extraordinary, their impact in the year are very strong. Further on, we will give more detail on the impact related to the change in accounting of the Rumo contract and these other costs.

We went from net income of R$43 million in 2013 to a loss of R$1.9 billion in 2014. Out of this loss, R$1.1 billion relates to the effect of the impairment of assets, which we will talk in more detail further on. We also had the impact of EBITDA reduction as I just mentioned and the increase in net financial expenses by approximately R$360 million, which we will also explain later on, on this call.

With this, we will move to the next slide, number six, please. Talking a little bit more about the market outlook in 2014. Let us divide our analysis by commodity in the 1H and 2H of the year, and by industrial products, which had very different dynamics. When we talk about the 1H regarding soybean, the crop flow started very well in the 1Q14. And two, we had demand problems with China, which decreased shipment due to the fact that both Brazil and the United States could oversupply the Chinese orders. Given that, especially as for May, we started to lose performance in volumes, while maintaining our contracted tariffs and losing some market share in the ports in which we operate.

In the 2H, when the off-season corn crop started, the dynamic was quite different. Exports of Brazilian corn were 22% lower than the previous year, from 26.6 million tonnes to 21 million tonnes, and we also faced strong competition from truck business freight, which presented a strong price reduction, pressuring railroad freights. We took a while to react in terms of prices. Our tariff prices decreased 7% compared to last year, thus we lost volumes which ended up falling 13% compared to the previous year.

Yet, our market share in ports grew from 45% to 54%. In the soybean meal, we had a significant increase in volumes by 15% versus the previous year, with tariffs also increasing by 13% on average, and with market share growing from 28% to 34% year over year.

In sugar, despite the 13% decrease in the volume of sugar exports from the South Central ports, ALL increased volumes transported by 5.6% in both Sao Paulo and Parana states. Sugar's average tariff price increased on average by 11% and the market share grew from 26% to 31%. In Industrialized Products, our actual performance was close to our expectations, up by 4.6%.

Moving on to the next slide, number seven, please. The volume transported increased by 3.3% in 2014 versus 2013, with growth of 2.8% in the volume of agricultural commodities and of 4.6% in industrial products. In terms of net revenues, we had an increase of 6.1%, partially due to the increase in volume in the combination of tariff increase and product mix. Taking into consideration, the average inflation of 7% in the year, this means that the combination of the mix of products in tariff adjustments were not enough to reach a good equation to reflect adequate and healthy growth in our sales revenues.

As a result of these factors, that I just mentioned and other costs, the impact that we had in the year, mainly extraordinary in non-recurring costs, we ended up reporting an EBITDA for the rail operations that was 45% lower than that recorded in the previous year, from R$1.7 billion to R$941 million.

In addition to the adjustment for change in the accounting practice related to the contract with Rumo, which impacted approximately R$360 million on the EBTIDA compared to the previous years, we will talk a little bit further on about other effects of cost expenses in the EBITDA reduction.

Moving on to the next slide, number eight. I would like to talk a little bit about Brado. This business reported a 20% increase in volumes transported versus the previous year, but an average tariff decreasing by approximately 14%, which resulted in net revenue year-over-year growth of only 4%. Brado recorded an EBITDA of R$72 million, compared with R$55 million in the previous year, an increase of 31%.

The next slide, number nine, lists the main accounting adjustments that impacted the financial statements that we have reported yesterday, either by direct impact on income for the year or by the change that we have to do by reopening previous year's statements and adjusting them.

Let me start with the impairment of assets. Companies are required on an annual basis by the IFRS to perform an assessment to analyze if there are conditions that indicates that there may be an impairment on assets.

Unlike previous years, when these conditions were not present, in 2014 we had several situations that made us understand that those conditions were present. And so, we had to perform the impairment test. This impairment test reveals the need for provisioning for losses of intangible assets and fixed assets of the south and west rail tracks, reaching around R$680 million of impairment.

In addition, considering the plans to substitute all locomotives for a new one, we also made an adjustment to bring the residual value of these locomotives to the value of probable economic recovery, which led to an impairment of approximately R$430 million in complement of the previous one mentioned. As a result, we ended up with the total assets of R$1.1 billion in impairment of assets for the year ended December 2014.

Let us talk now about the change in accounting of the Rumo contract. Today, as we are discussing only ALL year results, which do not include the annual assets of the consolidation process, which only takes place from April 1st, today, we are not talking here about the consolidated figures of ALL with Rumo. So, while we are talking here, we are only mentioning about ALL results.

So, in the last seven months, the transition team that was created by the two companies to prepare a business plan and understand the opportunities and the reality of the Company, also performed a deep analysis of the main accounting practices that ALL had and had been adopting and, specifically in this case, the contract with Rumo, we have identified an opportunity and a necessity to make a change in the accounting practice.

After several internal and external discussions, including ones with the auditors, we managed to convince everyone that we needed to change the practice that had been adopted, which was to treat the contract with Rumo as if it was a financial lease, to an incentive received from client method.

With this, after all adjustments made in previous years, we ended up having an impact in 2014 that we treated as cost of sales of approximately R$410 million versus an effect of approximately R$50 million in 2013. In addition to these major impacts related to the change in accounting of the Rumo contract with ALL, we had also several other extraordinary and non-recurring costs that happened during the year and eventually affected the reported result, which we will go into more detail later on in the presentation.

We also had adjustments from operations previously recorded as operating leases, which are actually finance leases. The impact here is primarily on the balance sheet, fixed assets against lease payable, but now we have a benefit in net income, as previously these operating leases were affecting the costs, and now the payments are partially payment of principal and partially interests.

This adjustment also affected the CAPEX figure reported in 2013 in approximately R$290 million, since it was considered as CAPEX reducer, which in fact it should have been treated as sale lease back and therefore as a capital lease.

Another adjustment was the reclassification of a portion of the concession leasing expense that has been treated as a financial expense for cost of goods sold. Taking into consideration that this is an operational lease, it is not correct to split the payment in three parts as cost of goods sold and part as financial income, as was being done. This is just a reclassification between lines in the income statement, but it was something close to R$150 million per each year.

We also made adjustments for incentive received from clients and trade agreement. In such cases, we had to recognize obligations previously not recorded in the balance sheet and make their adjustments in previous years, something close to R$230 million in December of 2014.

To finalize this theme of material adjustment, we reclassify our balance previously treated as cash and cash equivalents, which were reclassified on the balance sheet as marketable securities and some balance as restricted cash. These reclassifications impacted all our reported cash flow.

Let us now move on to slide ten. For us to better demonstrate the impact of these adjustments on the Company's EBITDA, here we have the first cascade graph on the top part of the slide, which shows EBITDA reconciliation previously reported in 2013 of R$1.8 billion to the adjusted one that we are restating of R$1.6 billion. Before talking about these adjustments in the first graph, we are showing the EBITDA reconciliation the way it was previously presented before CVM instruction 527, in the official form of which contains the effect of the result of equity income as part of the reportable EBITDA.

There are two positive impacts related to adjustments of clients incentives and financial leasing, previously explained and that benefited EBITDA in approximately R$100 million. Among the negative impact, the highlight would be the reclassification of the interest expense of the concession leasing to cost of goods sold in the amount of R$147 million and also the 2013 result of Ritmo which was reclassified to discontinued operations in the amount of R$25 million, considering that the sale of this business is already resolved and approved by the end of 2014.

In the second cascade graph, we made a standardization of the accounting result reported in 2014, considering that in management's judgment, there were some effects considered extraordinary and they should not be recurring. The first concern is a piece of the adjustment by the new form of recording the Rumo contract, which as I said earlier had a negative result of R$410 million in 2014 and we believe that out of these amounts, R$193 million refers to a portion of adjustment that should not be recurring.

Additionally, we had two provisions for write-offs, one related to receivables from the federal government, and one for IPI tax credits, which are non-recurrent and therefore should be treated as proposed here for purposes of analysis of a normalized EBITDA.

Going to the next slide. We show here our breakdown of the impairment effect that was recorded in 2014, totaling R$1.1 billion, of which R$427 million comes from our write-down of the book value of certain locomotives that will be replaced in 2015 and 2016, and R$676 million of impairment calculated in the south and west rail tracks.

In the case of the west track, the plan to discontinue the Vetria project was the main event that justifies the revision in cash flow projections and, as a result, the impairment. In the case of the south track, unfortunately what we have seen in recent years is reduction in volumes and loss of productivity, which strongly impacted our profitability and consequently ended up generating an adjustment in future cash flow projections of this rail track, which eventually called the impairment.

Moving on to the next slide. In the case of financial expenses, we had a 40% expansion in 2014 versus 2013, which is an absolute increase of around R$365 million. First, we had a net impact of charges on debt net of financial marketable securities of approximately R$600 million, justified primarily by an increase in interest rates, the CDI, which was on average around 8% in 2013 and 11% in 2014. Besides the effect of the average increase in net debt balance is year over year. We also had an extraordinary and non-recurring asset in the line of other charges in monetary variations due to a provision for impairment of balance of IPI credit.

The total value of this loss for the year was a R$150 million of which R$50 million impacted EBITDA because this was the original value of the asset, and the rest, which was R$100 million represented by its monetary update over the years, since the acquisition of this credit was written off against interest expense on this line.

Another impact that helped the understanding of the increase in financial expenses is the interest that we recorded related to the provision of the concession and lease payables of Paulista and West track, because of the claims of economic imbalance of the contracts.

These provisions are being updated by the Selic rate, which increased significantly in 2014 compared to 2013, as already mentioned. But we also have the impact on the increase in the recorded balance, which was the basis for these interest calculations. For you to have an idea we are talking about a provision that totaled R$1.8 billion in December 2014.

Finally, in the case of financial costs of leasing, we had an increase of approximately R$145 million year over year, mainly due to new financial leasing transactions, which started in late 2013.

Moving on to the next slide, we show here our bank debt position net of cash and investments. As can be seen our leverage on December 31st, 2014 reached a very high level, 5x times net debt EBITDA mainly due to the effect already mentioned that reduced EBITDA in the year. If we consider the normalized EBITDA in 2014 of R$1.360 million, R$1.3 billion, this leverage would have been of 3.9x on the same date.

As you all know, in this was a subject of the material fact that was released yesterday, due to this level of leverage ALL was non-compliant with some clauses of financial covenants, so we ended up having to reclassify approximately R$4.5 billion for long term to short term liabilities. However, over the last few months, we requested and obtained a waiver from ALL main creditors so we are not expecting any practical consequence on behalf of this technical default.

The only debt that lies is the fact that we should pay the eighth and ninth debentures in advance of their original maturities, which are outstanding in the market and we understand we will not get a waiver for them. For this reason, we negotiated with a pool of banks a standby credit line of up to R$1.4 billion to cover these maturities in 2015, with a three-year term and market conditions.

Aside from BNDES, which gave us a specific waiver for non-compliance on December 31st, 2014 still conditioned to the delivery of a report that will be prepared by April 30th, 2015, all other creditors who gave us the waiver accepted a leverage covenant of up to 5.5x EBITDA. This level of leverage will enable the implementation of the business plan designed by the transition team without any Company additional equity capitalization.

We are forecasting that this level of leverage, which will be measuring the consolidated RUMO plus ALL should start to reduce by approximately 0.5x from 2017 onwards, when the most significant investment of the plan will start to generate more expressive benefits.

In the case of BNDES, which has no quarterly covenants, at the end of the year, we are planning to start the process of discussion on these leverage levels and our expectation is that we have the same level of leverage agreed with other financial agents – in other words, 5.5x.

I would like to finish my presentation here and we are now available to start the Q&A session. I am available along with Alexandre Santoro, the CEO of ALL, Daniel Rockenbach, COO of ALL, Guilherme Machado, our Investor Relations manager, as well as the team from our financial department. We also have here today, Marcos Lutz, Cosan's CEO. But before we start our Q&A session, I would like to turn over to Mr. Guilherme Machado, who will make an announcement.

Guilherme Machado:

Very briefly I would like to highlight that on April, 23rd we have an intention to make, you know, an Investor Meeting which we will disclose the investment plan that Cezario mentioned. So, just for the purpose for you to keep in mind and make appropriately schedule on your agendas for April 23rd, when we are going to announce the investment plan.

So, we can start the Q&A session. Thank you.

Alexandre Falcão, HSBC:

Good afternoon, everyone. Just wanted to explore a little bit the cash generation for 2014, and out of the R$800 million of cash consumption, you see that there is probably R$200 million operating cash or difference between cash at beginning and the end of the period that's R$200 million on retain cash, and they are I would say another R$200 million, which would basically are the reclassifications of some of your leases.

My question is, and there is probably another R$100 million and some, which are the discontinuation of some of these activities. What is the rest of that? It is mainly worst performing assets or worst performing, the company performing worse or this is mainly some of the issues on the way you account for things and this is basically you are starting fresh here and then this is the new level that we should start seeing from now on? Thank you.

José Cezario Menezes de Barros Sobrinho:

Falcão, actually what we saw in 2014 was a very difficult and challenging year. We are not talking here about accounting aspects that has really impacted the cash flow generation. What we saw in 2014 was a worse cash generation, and due to all the aspects I have mentioned in terms of additions in costs and extraordinary costs, lower than expected tariff prices increases and so on.

So, what we could expect for the next two years is something of course better than what we saw in 2014. Basically due to several initiatives that we are going to put in place according to our investment plan. But 2014 was as reported. So I am afraid, it is not good to compare that with previous year, of course the dynamics of this industry is not so easy to compare. So, that is it, I think.

Alexandre Falcão:

OK. And then one more, just a follow-up here. Do you guys plan any sort of capital increase anytime soon, given that, because of the covenants break, mainly your short-term debts went through the roof, do you need anything like that?

And of course have the commitment on the offer of not doing this 18 months after and is that something that is in the short-term horizon or that is subject to the extension of the concession? Thank you.

José Cezario Menezes de Barros Sobrinho:

No, it is not in our plan. We are not considering any capital increase for the next years. Our business plan was made considering the level of indebtedness that is compatible with the covenants that we negotiated with the creditors. So, we believe that the CAPEX will be made mainly financed by BNDES, of course, it is a normal thing to this kind of business. And we are not considering any kind of capital increase for the next years.

Alexandre Falcão:

OK, perfect. Thank you.

Victor Mizusaki, Bradesco BBA:

Hi. Good afternoon. I have two questions. The first one, today you have Cosan Logística and Rumo listed in the Brazilian stock exchange. Is there any plan to merge these two stocks?

And the second question, when we take a look at the financial statement, as you mentioned, there is the impairment of R$1.1 billion and around R$580 million related to operating impacts. Can you elaborate a little bit more about this write-off, and is there any chance that we are likely to see new impairments in the coming quarters.

José Cezario Menezes de Barros Sobrinho:

In terms of the first question, perhaps this can happen in some moment in the future, but we do not have any plan made in this aspect for the year, for the current year or the next one. Yes, it can happen, but we do not have any deadline or date to consider right now.

Talking about impairments you mentioned, we made these adjustments on December 31st as the result a test, an impairment test that is required in the accounting rules. The impairments can be divided in two parts. The first one is quite easy to understand. We have a plan to renew some locomotives, and what we did is revalued, we analyzed the real value of these assets and we write down these values to a recoverable amount as of the end of the operation of such asset. We ended up with an adjustment of R$427 million coming from these aspects, specifically.

Additionally to that, we had aspects that made us perform the impairment test for the south and west concessions. The west concession basically was impacted by the decision that we took at the end of last year, to discontinue the Vetria project and therefore the cash flow generations forecasted were not enough to absorb the depreciation for the next two years. And therefore, we ended up with the adjustments for the West concession.

And the same procedures we made to the South concession. At the South concession, what we are experienced is a reduction in the volumes year over year in the past years, and when we made the projections of cash flow and considered the capacity to absorb the amortization and depreciation for such concessions, which is a cash generation unit for accounting purpose, we had to make these adjustments, these impairment adjustments, which was something around R$676 million and considering both West and South concessions. I hope I have answered your question.

Victor Mizusaki:

Yes. Just one last question regarding the compensation plan for the senior management. In the past, it was really focused on the EBITDA, is there any change in for the new management, and what can we expect in terms of stock options and the stock price and this kind of detail.

José Cezario Menezes de Barros Sobrinho:

There will be some change of course, it is not finally decided, but probably the EBITDA will still be a part of the target, but of course we are going to include other metrics, KPIs such as cash flow generation, return on employed capital and so on. So it is not finalize the metrics to the new senior management, but there probably will be some change.

Victor Mizusaki:

OK, thank you.

Bruno Amorim, Santander:

Hi good afternoon. I have a question maybe to Cosan, to Mr. Marcos Lutz, if possible. I would like to know if Cosan Logística will remain listed, and if this is the case, I would like to know if you have any intention to buy other assets through this vehicle. Thank you.

Marcos Lutz:

Bruno, Cosan Logística will not buy any others assets, but they are holdings in ALL and Rumo companies. We have the intention at some point, when it makes sense, to delist this entity as well. So, we do not intend to have this additional layer on the longer run. We want to make sure that we will be able to implement the turnaround needed on this entity we are announcing today.

But obviously on the long run, it makes very little sense for us to keep our additional layer that will only add discounts and destroy value to shareholders. So we do not have schedule for that, we do not have a defined plan and strategy set because this is not top one priority. We have to use this leverage power for, I mean this leverage control to actually make sure the plan is implemented.

But at the end this that you mentioned will make sense. And reinforcing the first question, this entity will solely have ALL Rumo business as a business.

Bruno Amorim:

Thank you very much.

John Moura, Bank of America/Merrill Lynch:

Hi, thanks for the call. I have just one question regarding these debt restructuring that you are doing in terms of covenants. If you could elaborate more on the amount of that you are raising and the amount that you are prepaying and the delta, the cost of that in both. If that is possible, that would be great for us. Thank you.

José Cezario Menezes de Barros Sobrinho:

Could you repeat your question, please?

John Moura:

You said that in the case a great part of your debt is short term because of the covenant paying, and you said you were going to prepay part of the debentures and that you are going to raise some debt to do so. If you could just elaborate more on that and what is the amount that you are prepaying and what is the cost of the debt you are raising. That would be great for us. Thank you.

José Cezario Menezes de Barros Sobrinho:

OK. The debt amount that will be probably prepaid is around R$1.4 billion, which is the same amount we are raising from a pool of banks. This debt that we are going to raise has market conditions related to CDI. It is something around 120% of CDI and with three years of term.

John Moura:

OK. Great.

José Cezario Menezes de Barros Sobrinho:

OK. Just one addition. It is important to mention that once we finalize the next quarter, and of course all the waivers have been received, which is the case, the significant part of the amounts that have been reclassified from the long-term to the short-term will be reversed and will be cited in the long-term again. So, just to clarify this point.

John Moura:

OK. That is very clear.

Rogério Araújo, Brasil Plural:

Good afternoon. Thanks for the question. I have a quick question regarding the financial lease contracts that were reclassified as financial expenses. I want to know how much was the OPEX related to these contracts in 2013, which we should not see any longer in EBITDA going forward. Thank you.

José Cezario Menezes de Barros Sobrinho:

Just a second. OK. In 2013, we had R$43 million that was adjusted from the cost. This amount, as we mentioned, it was reconsidered as a financial lease. We are not treating it as lease payment expense, but instead of that all payments have been reclassified as a reduction of the liability originally recorded. So that is the main difference, the main aspects that have to be considered. So, in 2013, the amount that has been classified totaled R$43 million, benefiting the EBITDA result.

Rogério Araújo:

Okay. That is great. Just one more question regarding, actually it is a follow-up from a former question on Cosan Logística. I know there is no time for the delisting of this company, but have you already thought about the options, if you would do either a tender offer on RLOG or even if you think about a share swap between.

José Cezario Menezes de Barros Sobrinho:

Well, I think in the end of your question you were cut, but again we have not planned, therefore, we have no structure already set for delisting RLOG. So, we have obviously seen options and possibilities but, again, it is not a priority now. And this structure was not discussed or defined yet.

Operator:

This concludes the question-and-answer session for investors and analyst. Mr. José Cezario, you may proceed with your closing statements.

José Cezario Menezes de Barros Sobrinho:

I would like to thank you everyone for participating in our conference call. And have a good day.

Operator:

This concludes ALL's conference call for today. Thank you very much for your participation, and have a good afternoon.