International Conference Call
São Martinho (SMTO3)
1Q24 Earnings Results
Crop 2023/2024
August 15th, 2023

Operator: Good afternoon, ladies and gentlemen, and thank you for holding. Welcome to São Martinho S/A's earnings conference call to discuss the first quarter of the 23/24 harvest.

Today with us we have Mr. Felipe Vicchiato, São Martinho's Chief Financial and Investor Relations Officer, Alessandro Soares, Investor Relations and New Business Manager, as well as the investor relation team.

The audio and the slides of the call are being simultaneously broadcast on the internet at www.saomartinho.com.br/ir. We would like to inform you that participants will be able to just listen to the conference call during the company's presentation. Afterwards, we will begin the Q&A session for investors and analysts, and further instructions will be given. Should you need assistance during the conference call, please press *0 to for an operator.

We would also like to that information provided during this conference call may constitute forward-looking statements. Such statements are subject to known and unknown risks and uncertainties that could cause the company's actual results to not materialize or differ materially from the expectations.

I will turn the floor to Mr. Felipe Vicchiato, who will start the conference call. Thank you.

Felipe Vicchiato: Good afternoon, thank you for your attendance at São Martinho's conference call about the first quarter of the 23/24 crop.

Going straight to page 3, we'll go through the quarter's operating results. Moving on to financial highlights, cash cost and the expectation to close this cash cost until the end of the fiscal year, the ethanol market combined with the competitiveness of ethanol in line with what happened throughout the year and the expectation of the reduction and the price of fuels, sugar hedge, what our hedge position is at this time and then talk a little bit about our cornmeal operation.

So, moving to page 4, operational highlights, the company on the first quarter processed 7.6 million tons of sugar cane, 2.8% less than less than las year given to a climate condition, the beginning of the crop was very rainy and the beginning of the harvest, or the crop, started 2 weeks later than when we regularly would start. On the other hand, TCH had a significant growth in this first quarter of the harvest, going from 71 ton per hectare to 82 tons per hectare with an average TRS dropping

1.2%, and corn we processed 103.900 tons with a production of about 37,000 m³ of corn ethanol.

As we mentioned in the previous quarter with the corn guidance, we'll be professing a little bit less this harvest than the total corn capacity considering the conditions to begin crushing that was slightly more complicated than we expected. In terms of sugar operations of production, we grew 1.9% in sugar production coming from 715,000 tons to 423 from 415, and the sugar mix of all units in São Paulo, and ethanol also growing 3.2% considering the participance of corn ethanol, we're talking about a decrease on sugar cane ethanol of around 8% since, as we already said, we migrated the entire production to sugar and less to ethanol.

With this volume of sugar cane processed and considering the current field conditions, we understand that by the end of the harvest we'll be able to reach the guidance of 21.5 million tons of sugar cane even if there's a little bit less sugar cane, it would be difficult to process all of it till the end of the harvest considering the weather conditions that starting in September will probably be rainier than usually.

On the next slide, we see the financial highlights. Our net revenue went down 20% coming from 1.7 billion last quarter to 1.3 billion in this first quarter due mostly to the drop in the price of ethanol of around 20% and a drop in the volume of ethanol sold of around 41%, offset partially by the higher volume of sugar sold, 21.7%, and higher sugar prices of 22.6%.

Considering our revenue, our adjusted went down 36% with the margin of 41% and EBIT of R$215 million with the margin of 15.9%. Accounting income was stable compared to last year, closing at R$220 million and cash income dropped 45% quarter on quarter. When we look at the difference between net income and cash income, the main variations here are due to the biological asset, R$129 million, it's a positive mark up this quarter mostly due to the better prices of sugar and better yield. There's also an adjustment of swap item and IFRS adjustments, that's most of what comes from net income to cash income. But for cash, it's the best indication for the operation and we have a drop on the quarter of 45%.

Next. We see cash cost for sugar and ethanol that at this time we can't see this quarter any reflection of the higher operating leverage that the company will have with more crushing, but quarter on quarter we see an increase of the cash cost of sugar, 19.7% getting to R$1.942,00 per ton, as well as an increase in the cash cost of ethanol from R$2.845,00 per m³, 11% more than last year.

To make it easier to analyze, we isolated Consecana for the cost of sugar and Consecana for ethanol, only for the cost of ethanol. That's with the margins of the projects. That's how we prefer to look at to better assess the mix. We estimate that this cash cost of sugar should close at around R$1.956,00 million per ton at the end of the year, 3% higher than last year, and especially due to the increase of Consecana for sugar, the product prices are quite high, 24.5%, but on the other hand, ethanol would probably go down 11% from 2.7 to R$2.4 per liter, and if the combination of both, what remain is about 7 to 8% less cash cost for TRS, that's the operational leverage that the company will have with this higher rate of crushing, and there's also a smaller individual cost of some items, for example, fertilizers that on average from last year dropped 27%, some industrial inputs that went down around 18 to 20%. So, that's the initial estimates that we have that will be needed to close the cash cost at the end of this harvest.

Next. We see a little of the ethanol market, how it behaved throughout the year. Hydrous ethanol, that's the base for the pricing of anhydrous ethanol, hydrous ethanol from São Paulo we had a drop when compared January with August of around 26%. A series of changes happened during this year, in the beginning of the year we had the refund of state and federal taxes followed by a sequence of drop in the prices of gasoline at the refineries, and an increase that was announced today for this gasoline at refineries that offsets part of this drop, but not entirely.

On the following slide, we have more details about this price movement of gasoline A and taxes in January producers were making something close to R$2,69 per liter. At the time, we had a gasoline at the refinery of around R$3,23, there were a series of changes in the taxes making gasoline and ethanol exempt and this was a return of what we had at the beginning of… it was actually a resumption of tax collection of PIS COFINS, the state was *ad-rem* improving ethanol's competitiveness a little bit.

And if we isolate the tax aspect, if there was no drop on the fuel, we would say that ethanol should go up around R$0.46 going to R$3,15 for producers. But during these months, the price of gasoline at the refineries went down, close to 20-25%, but the increase today, 16% that was announced this morning, we're talking about a drop of 9%. All of that combined added to lower parity because in the beginning of the year the parity was of around 75% at the pump, and today we're running at 64-62% at the pump, and that makes the prices for producers should stay, today it's 2,11, and with the adjustment made today, it will probably be close to 2,29-2,30.

It's also worth noting that today they also announced an increase on diesel for 25%. And at São Martinho we have an important part of our costs in diesel, we buy today more or less R$400 million per year in diesel, and we will have a full impact of this increase on the diesel price now in our production cost.

Remembering that we already bought almost 40% of the harvest in terms of diesel, most of the volume is during the harvest, so we have 60% to buy, that's the end of the crop, and the second crop that we use diesel for planting mostly.

On the following slide, we'll talk a little bit about the sugar market. In June, the company had 68% of the volume of owned sugar that's still going to be billed protected, close to R$2.600,00 per ton, and for next year we had almost nothing sold, only 30,000 tons. That's under 3% of our own cane. We have a very constructive view of the sugar market considering the climate conditions in India, the limitation in Brazil is having a too large a harvest because of climate, weather aspects that may occur in the second half of the year with an expected higher volume of rains. So, we're being cautious and hedging too. We believe there's still room for this price to be at a higher level even considering all of the lines in Brazil and turning the mix as much as possible to sugar.

So, that's our position at this time in terms of sugar believing that prices will continue to be constructed.

On the next slide, and to finalize our presentation and open for questions, we have a summary of our corn position. We've reinforced the guidance that we published in June of 420,000 tons of corn, we already have 100% of this volume purchased at a price of R$74,00 per sack of corn, this price is higher than the market price today. Considering a surprise in the corn production in the Mato Grosso do Sul, Mato Grosso and Goiás region combined to the fiscal movement for export, the prices changed in the region and dropped, and we had already purchased a lot. And considering that crushing was below what we expected, we expected to be close to 500,000 tons and will be at only 420,000 tons, when we bought this corn, this information was not available. And so, today, we have it almost 100% purpose. We're making 160,000 m³ of ethanol, ethanol there is predominantly anhydrous ethanol and 134 tons of DDGS.

You must have seen in our release that the corn operation had a negative result this quarter, this first quarter, and the main reason was that we began at very low crushing levels in some days, even less than 50% of the capacity with the DDGS a little bit outside of specification, so we had to sell the discount. But this has been normalized and today we're crushing slightly more than 1.200 tons of corn per day.

We expect everything to be more constant considering that the current DDGS prices and current ethanol prices after this adjustments that this will be an operation where we'll get a positive result at the end of the year between R$50 and 70 million. We started imagining it would be higher, but with these operational conditions that we faced, we believe it will be in that range. It's not going to be anything extremely relevant for this year, but next year, with the price of corn at a different level and our operational ready smoothly in terms of crushing per day, we expect to get very relevant cash generation in the corn plant.

These are my opening remarks, and we'll open for questions and answers. Thank you.

Question and Answer Session

Operator: We will now begin the question-and-answer session for analysts and investors. If you would like to ask a question, please dial * 1.

We'll begin today's Q&A session with a question from Guilherme Palhares, Bank of America.

Guilherme Palhares: Good morning, Felipe. Two quick questions from our side. Talking about corn ethanol still, I'd like to ask about this price hedging, and we see it starting even if at a small volume for the next hedging season or crop, is it something coming from this harvest that will be carried over to the next one due to the lower volume produced, or in the start of operations, or do we see the company starting to fix this? And what you mentioned of price levels, now that we see that the levels in the region are depressed considering the basis.

And my second point would be about crushing itself. We're seeing a strong recovery of TCH and crushing is still slow and it will probably start to keep up from now on, but I'd like to understand a little bit more of how you're thinking in the mix about your own sugar cane and third-party cane, if there's any difficulties to progress with crushing, with what would be the full production capacity for the company. What would be the potential? What are you thinking in terms of the mix between owned cane and third parties?

Felipe Vicchiato: Good afternoon, Guilherme. Thank you for your questions. About corn, the small volume that was carried over to the other crop is due precisely to that operational aspect where initially expecting a crushing of 495,000 tons and we were buying corn and signing contracts with suppliers ended up to be slightly over necessarily, we won't be able to crush everything in this crop, so some of it is carrying over to the next crop. It's not a hedge to the next crop, it's simply a matter of crushing that was a little bit more difficult in this beginning.

Your second question, about our own sugar cane and third-party cane, we will probably be around a proportion of 70-30. 70% are own cane and 30% third-party. And in unit terms we'll crush 100% of third-party sugar cane, if there's cane leftover it's going to be our own. Today we are obliged to crush third-party sugar cane and we cannot leave our supplier hanging with sugar cane on the field. So, third parties are priority, we crush what is contracted, but if it starts raining too much and we have sugar cane leftover, we'll end up crushing it, it's going to be our own in the next crop.

Usually, stand over cane is our own cane.

Guilherme Palhares: Excellent. Thank you.

Operator: Next question Leonardo Alencar from, XP.

Leonardo Alencar: Good afternoon, Felipe. I wanted to get a little deeper in the information you gave us about the agricultural aspect, the TCH data. There are recurring points of discussion in your guidance, that was being conservative, but now with this evolution in the beginning of harvest and TCH numbers being much better, I'd like to know if you're adjusting your expectations. If you're going to consider a more comfortable range. And in line with that, you said there was not so much effect of cost dilution in the first quarter, but if you get into more details, how fast would you believe this will happen in coming quarters the cost dilution because of the yield or if the yield will be above what was expected in the beginning of the harvest? If there's way to be a more favorable condition than what was initially expected.

Felipe Vicchiato: Leonardo, when we released our guidance, we had already mapped this good yield, and as it happens, the crushing guidance of 21.5 is for crushing, not necessarily sugar cane, so there will probably be sugar cane leftover in this condition on the field and carry over to the next crop.

If for some reason the weather is drier than what we are expecting, if the El Niño phenomenon is not that relevant, then yes, we would be able to crush the standard cane in our fields. So, the guidance of 21.5 million is for crushing.

As for the fixed cost dilution, this happens mostly in the second and third quarters, so probably closer and crushing in the third quarter, that's until November/December this year. So, in the second quarter, you'll already be able to see the dilution of fixed cost in a more significant way.

Operator: Next question, Matheus Enfeldt, UBS.

Matheus Enfeldt: Good afternoon, Felipe, Alessandro. My first question is to understand the company's selling strategy, the volume of ethanol sales was very low, sugar was more in line with the fourth quarter, but what are you thinking about in terms of ethanol sales? How much ethanol can you hold on to? With the potential of maybe having a longer off season, how do you see that and what are the triggers for you to sell more or less ethanol? And how do you see the exposure to exports in the second quarter of the harvest? And of course, the Petrobras factor changes the scenario a little, but if you can detail your expectation.

In capital allocation, you had some projects being discussed and the company mentioned in previous calls about the second phase of corn ethanol thinking about flexibility. So, now what do you have as a priority in terms of the studies for the company thinking about the next six months, seven months until the end of the crop? And when does the company expect to make these decisions in terms of capital allocation? Thank you.

Felipe Vicchiato: Thank you for your question. So, as for the ethanol sales, actually, the first quarter we sold less ethanol than last quarter because there was a point over the last 45 days of the quarter that the price of the product went down too much, very quickly, and with that we made the decision to hold on to it, not sell as much because effectively it was well below parity of 70%, and at some point even below cost.

So, as I said, our estimate for ethanol cash cost for this harvest is around R$2.4 per liter. If we look at Esalq's data today, ethanol is below this value, hydrous ethanol be it due to prices that until yesterday was well below parity, international parity, or be it for that ratio of 70% that was running at 62% here in São Paulo, that's the highest consuming state. So, there was a point of ethanol that the mills were selling the product below cost, and that was a big concern. Today there was a significant correction with Petrobras closing part of that gap on the price difference, it increased 16% that is relevant for us.

And then I'll go into your second question of capital allocation. Considering the current scenario, we understand that it's not the time to make any assessment to expand the corn at Boa Vista with the second stage producing more ethanol even if the base is cheap. We're first going to wait for the operation to be leveled and balanced to have a full year and then we'll make that decision.

So, I don't expect to have any decision of doubling the corn plant, the corn ethanol plant until the end of the year. Biomethane, we're still looking into it, there's an aspect of the regulation of biomethane that's being discussed that's also important to us to see with the CBIO and so on, and capital allocation is basically for payment to shareholders dividends rather than making big investments in the expansion at this time.

Matheus Enfeldt: Great. Thank you.

Operator: Next question, Henrique Brustolin, BTG Pactual.

Henrique Brustolin: Good afternoon, Felipe, Alessandro, IR team. I'd like to start with a follow-up from crushing. Of course, the yield recovery this year is very relevant, there's even some sugar cane leftover, but the doubt is that in the pace that you have of crushing at this time, do you see any risk to get to the 21.5 million tons for the year as you have been progressing until now? And at this point, with the weather conditions helping agricultural management with the new sugar cane varieties that you have and [unintelligible] field in recent years, how do you see the pace to get to those 24,000 tons that would fill the plants today for crushing?

And the second question about ethanol and prices, Felipe, I'd like to hear a little bit more. Of course, now there will be a recovery with that increase at Petrobras, but I'd like to hear a little bit more about parity with gasoline. We saw that big lag, the supply of ethanol growing this year boosted due to the recovery on crushing and the new offer of corn ethanol, but how do you see parity behaving throughout the crop? These are my questions. Thank you.

Felipe Vicchiato: Thank you for your questions. For your first question, actually, the beginning of the crop was a lot more blocked or stiff because of the volume of rains, rainfall was higher, it didn't rain continuously, but it rained for a few days, then it stopped, and it started again, and that really hinders the resumption of crushing. So, when we look quarter on quarter, it seems that crushing is [unintelligible], but from July onwards, weather is dry and we've been able to crush as much as we can every day, maximum capacity.

So, I think it's unlikely that we would not meet the 21.5 million tons guidance. If it rains less and the effect of El Niño as a whole is not as relevant, we may be able to crush even a little bit more. But at this time, I believe 21-21.5 is guaranteed, and to get to 24 million tons with the dream management and the varieties with the normal weather conditions for the next two years, we believe we can get there in two years, not next year, but for 26, the 26 harvest, we believe we would be able to be close to 24 million tons.

About the price difference and the parity, if the call was yesterday, I would have been more concerned because until now we've only seen the parity working down. The price had dropped until yesterday, 25% compared to gasoline. That was a parity in line with oil at the time. But since there has been this relevant increase, 16% increase all at once, is relevant. We believe that at the end of the day and Petrobras' mandated, I believe the 12-month window and the price of the product will have international parity.

So, they're respecting that, in this 12-month window they're making their adjustments. So, we believe that if the oil prices remain as they are, in the next coming months they'll continue adjusting until they get to parity. Also, there's a 12-month window for that. But I would say that based on today's information and the 16% increase, I think they will follow the policy, not at the same speed that they did a few years ago, but in 12 months we will see parity according to the international market.

Henrique Brustolin: That's clear. Thank you.

Operator: Lucas Ferreira, JP Morgan.

Lucas Ferreira: Hi Felipe. My question is about sugar prices. Last time we were together that we met, I believe your view was that the market was tight, there was a little downside and a lot of upside in risk and price considering the scenario for the second half of the year. But since it's always unpredictable, the numbers came out better than expected in terms of rain volume on the past month.

My question is, isn't it time to accelerate the hedging? The exchange rate is favorable, the price maybe you can aim at a better margin. What's your idea? And for return at this level of sugar prices and the perspective looking forward, if you feel more comfortable in hedging sugar prices more for this year and also for the next crop as well.

Felipe Vicchiato: Thank you for the question, Lucas. This year we're doing that because we're already very close to the end of the crop, 68% of the database in

June, we are more advanced, we're close to 80% already hedged of the remainder sugar. And for the next harvest, as much as it rained in India, I don't think it rained where they needed it, the main sugar cane producing region. So, we still believe that there's room for this price to remain strong. So, for now, we'll monitor it a little bit longer. We believe there's more upside than downside.

So, today we're around 3-4% for production of next year, we'll see how the rains will be in September/October here in Brazil, it may greatly hinder sugar production, especially from mills that aren't as efficient as the best in the country that takes too long to resume and when they resume it's predominantly with ethanol production and not sugar. So, we believe there may be a disappointment in Brazil the initial estimates with a very high volume.

So, we'll see. But right now, we're not setting it. We're waiting a little bit longer before we make that decision.

Lucas Ferreira: Great. Thank you.

Operator: Next question, Joaquim Athié, Citibank.

Joaquim Athié: Felipe, I just wanted to know if you can tell me a little bit more about your estimate for costs till the year and then with the harvest if you're going to purchase or if you can breakdown just the aspects of costs, if you can tell us whether we can see what to expect for the future, as well as maintenance CapEx and expansion, what you're thinking about? You had a guidance and I'd like to know about it. Thank you.

Felipe Vicchiato: So, in terms of cost, that's the number that I gave you during the presentation now, it's on page... looking here in the financial results, cash cost of sugar and ethanol, and this cash cost of sugar and ethanol includes maintenance CapEx. So, it's like my EBIT cost more or less. And this crop would have a drop of 11% for ethanol and due to the improvement of the company's operational leverage and the drop on the price of ethanol, and a 3.7% increase in the cash cost of sugar.

As for the guidance for investments, maintenance CapEx and so on, we maintain the same guidance that we provided 3 months ago, in June, or two months ago. There has been no change.

Joaquim Athié: Great. Thank you.

Operator: Ladies and gentlemen. I'd like to remind you that you ask the question, please dial *1. And if you'd. Like to remove your question from the queue, pressing the pound key. Please hold.

We conclude the questions and answer session. At this time, I would like to turn the floor back to Mr. Felipe Vicchiato for his final remarks.

Felipe Vicchiato: Well, thank you for your presence here at our conference call. The IR team and myself are available for any additional doubts you may have.

This has been a much better crop in agricultural terms than what we saw in the last two years. The first quarter we harvested little sugar cane, they'll be harvested from the second half onwards, so yield will probably increase more than what we saw in the first half.

On the agricultural point of view, we're going back to what we used to be 3-4 years ago. The challenge now is for price product, the price of products, especially ethanol considering that we have our position, but we have this concern, but with this position of Petrobras starting to close the price gap compared to the international market, it's very positive for us and makes us hopeful to continue growing in the near future.

Thank you very much. Good afternoon.

Operator: São Martinho's conference call is now over. We thank you for your participation. Have a great afternoon.