genial Equity Research

SLC AGRICOLA

3Q23 review: Against the grain

LatAm Agribusiness

Main takeaways:

(i) Invoiced volume grew in corn and cotton, but fell in soybeans; **(ii)** Prices rose in line with the market in corn, and a little more than our estimates in soybeans; **(iii)** Revenue up +25.5% y/y, slightly above our estimates; **(iv)** Input prices got in the way and created greater cost pressure, but hedges on pesticides are advancing and the situation may improve going forward; **(v)** EBITDA of R$492mn, up +25.5% y/y; **(vi)** Net Income of R$167mn, reversing last year's loss; **(vii)** We once again see the company with a **slightly more attractive price**, given the elastic drop of -11.5% after our downgrade last quarter. Trading today with a **24E EV/EBITDA** of **5.9x**, we now see better entry conditions to long positioning on the shares, and have **upgraded to BUY**, with an **unchanged 12M Target Price** of **R$47.00**, giving the stock an **upside** of **+22.27%**.

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Company

SLCE3 BZ Equity
Buy

Price: R$ 38.44 (08-Nov-2023)
Target Price 12M: R$ 47.00

SLC reported its 3Q23 results yesterday, November 8th, after the market closed. Overall, the figures were up, with an **increase in invoiced volume** and taking advantage of **higher commodity prices then our projections**, although **costs were also on the rise**.

Valuation and rating. In view of the devaluation of the shares following our rating downgrade last quarter, the stock has entered in a downtrend to -11.49% so far, indicating that we made a move against consensus at the time, but which proved to be correct. However, we are starting to see the upside return in fundamental terms, and with the deep dive, the company is becoming attractive once again. In our assessment, even in the face of adversity for agricultural commodities, SLC posted more satisfactory figures in 3Q23 than in the previous quarter, with a higher volume of cotton and corn, even considering the seasonality.

Although the hedge advance in cotton is well below historical levels, at 13.5%, we believe that the price dynamics specifically for this crop tend to be bullish, so that, although risky, SLC's slowness to hedge is based on a rationale that seems to make sense to us. On the other hand, we continue with our pessimistic view of corn and soybean prices. For soybeans, the price realized in 3Q23 was R$2,141/t (+2.1% vs. Genial Est.), down -18.0% y/y, but above our expectations. As for corn, the price realization reached R$961/t (+1.8% vs. Genial Est.), up +6.9% y/y.

Although the situation remains challenging for both crops, with the basis at the port being negative for soybeans, based on the delivery price being lower than the price of the commodity quoted on the stock exchange, we believe that this trend is due to a logistical bottleneck. Many producers seem to have held back supply and are now dispatching shipments. Demand is therefore somewhat more resilient, and the prices negotiated by SLC were higher than our estimates.

At the moment, we are not going to revise the assumptions for corn and soybeans in our model, and we prefer to maintain our bearish bias for both crops. However, as we mentioned, SLC's shares have fallen too much, and the company is trading today with a **24E EV/EBITDA of 5.9x vs. a historical average of 6.7x**, which seems reasonably discounted to us. We believe that the worst is over, with the price of soybeans showing an important recovery in the last month, but with the scenario still uncertain about pricing and the end of the logistics bottleneck ahead. We prefer to keep our **12M Target Price unchanged at R$47.00**, but **upgrade our rating to BUY,** with an **upside** of **+22.27%**, taking advantage of the company's good results in 3Q23, despite the still challenging price situation.

3Q23 Review

Volume invoiced and prices up for most crops. Reporting a volume of 670kt of corn (+18.1% y/y), 59kt of soybeans (-26.8% y/y) and 56kt of cotton (+54.7% y/y), we see solid numbers in 3Q23, despite most of them showing a slight drop in 9M23 vs. 9M22, with the exception of corn. At the same time, prices had different dynamics, being positive for corn and cotton, and negative for soybeans.

In the same vein, betting on a rise in the commodity, the company continues to be little advanced in hedging its cotton production, with 13.5% for the 23/24 harvest, seeking to expose itself to rising market prices. We see the company's behavior as risky, being well behind historical hedging. However, we understand SLC's point of view on cotton, since prices tend to rise due to stronger demand for clothing in the US, with the economy remaining resilient in services and discretionary goods, which encourages the consumption of cotton clothing.

In addition, because it brings more adequate returns than the others, corn production is being partially directed to cotton, with the area planted to cotton increasing by +16% y/y and corn shrinking -25% y/y for the expected 23/24 harvest.

Stronger consolidated revenue. Accordingly, SLC reported net revenue up +21.8% y/y to R$1.3bn (+1.2% vs. Genial Est.), above our projections, benefiting from both price and volume. On the other hand, revenues in the 9M23 accumulated period fell slightly, reflecting the lower quantity of cotton lint invoiced.

Rising main inputs created pressure on costs. Unit costs showed a consolidated increase of +23.8% y/y, driven by upward movements seen in cotton and soybeans, although corn retreated. The main reasons for this increase are: **(i)** the cotton invoiced in the current quarter comes from the 21/22 harvest, whose cost was higher due to lower productivity, and **(ii)** an increase in spending on some inputs in the current harvest, such as seeds, fertilizers, and pesticides, which are indexed to the dollar. As the USD/BRL exchange rate rose again, there was greater pressure on the cost of these inputs.

Adjusted EBITDA driven by corn and cotton. At an Adjusted EBITDA of R$492mn (+4.2% vs. Genial Est.), we saw an increase of +25.5% y/y, positively influenced by better results for corn and cotton crops, while soy continues to have poor price dynamics. Added to a result with hedges of R$198mn, net income was reported at R$167mn (+16,3% vs. Genial Est.), reversing the loss of -R$78mn in 3Q22, and being delivered above our projections.

Table 1. Income Statement SLC (3Q23 vs. Genial Est.)

(R$ millions)	3Q23 Reported	3Q23E Genial Est.	% R/E	3Q22 Reported	% y/y
Net Revenue	**1.648**	**1.599**	**3,1%**	**1.353**	**21,8%**
COGS	(1.188)	(1.141)	4,2%	(960)	23,8%
Adjusted EBITDA	**492**	**472**	**4,2%**	**392**	**25,5%**
EBITDA Margin (%)	29,8%	29,5%	0,31p.p	29,0%	0,58p.p
EBIT	**415**	**384**	**8,1%**	**48**	**760,4%**
EBIT Margin (%)	25,2%	24,0%	1,17p.p	3,6%	20,44p.p
D&A	(57)	(52)	9,9%	(36)	60,5%
Financial Result	(191)	(189)	1,2%	(193)	-0,9%
Net Income	**167**	**144**	**16,3%**	**(78)**	**-**
Net Margin (%)	10,1%	9,0%	1,15p.p	-5,8%	14,79p.p

Soure: SLC, Genial Investimentos

Our Take on SLC

After completing purchases for inputs for the 23/24 harvest, SLC had a solid result in 3Q23, with numbers up year-on-year. Although we have a more negative bias for 2 of its 3 commodities, **(i)** corn and **(ii)** soybeans, we saw an increase in realized prices during the period, which may indicate further downsides risk for prices going forward.

Looking ahead, 4Q23 should also come with a strong volume, given that there is still a significant amount of production to be invoiced, mainly in cotton and soybeans, and corn to a lesser extent. Logistics costs came under a lot of pressure in the 23/24 harvest, with a negative impact from the rise in oil prices and the USD/BRL exchange rate rising to close to ~R$5.00, which is also reflected in the company's main inputs. Even though inputs have come under a little more pressure, the advance of the hedge on the pesticides side has left SLC in a more comfortable position.

Stock split from 1 to 2. In addition, the proposal to split all of the company's existing ordinary shares was also approved, with each existing ordinary share corresponding to two ordinary shares, with the aim of increasing liquidity and facilitating access for non-professional investors.

Satisfactory cash flow generation in 3Q23 but remains short on 9M mark. In addition, free cash flow generation in 3Q23 was positive at R$580mn (+12% vs. Genial Est.), an increase of +70.4% y/y. The figure comes mainly from higher operating cash generation, with a release of working capital of R$208mn. However, when analyzing 9M23, the flow is negative at -R$248mn (vs. +R$209m in 9M22), caused by lower operating results and higher investments, and mainly by 2Q23 which presented a cash burn of -R$386mn. The entry into 3Q, a seasonally more favorable quarter for releasing working capital, explains a better performance in the cash cycle.

Against the grain. Despite SLC presenting promising figures in 3Q23, the current assumptions for the 23/24 corn and soybean harvests have not yet been revised in our model and remain in a downtrend. SLC's shares suffered a significant drop precisely after our downgrade 3M ago, just when the market was at the peak of optimism about the stock being undervalued. At the time, we took a “against the grain” stance by downgrading the company. Now, we have the opportunity to do the same thing, considering that the drop in intensity has started to make the shares to look attractive again. Trading at an **EV/EBITDA 24E** of **5.9x**, moderately **discounted** from the **historical average of 6.7x**. This is perceived by us as the end of the worst period, considering the partial recovery in soybean prices over the last month. However, we do not deny that price and logistics uncertainties persist.

Despite the challenging price conditions, based on the company's positive results in 3Q23, we have maintained our **12M Target Price** at **R$47.00, intact** from the previous assessment, but **raising** the company's **rating to BUY**, with an **upside** of **+22.27%**.

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	Definition	Coverage
Buy	Expected return above +10% in relation to the Company's sector average	**49%**
Neutral	Expected return between +10% and -10% relative to the Company's industry average	**41%**
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under Review	Under review	**5%**

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