SLC AGRICOLA

Farm Day 24: La Niña, the million-dollar baby

LatAm Agribusiness

Main takeaways:

(i) Biofuels, with a CAGR of +4% in the demand for soybeans for the production, was a trend that was much talked about at the event; **(ii)** Being **Asset Light** is still SLC's focus, so buying land is on the back burner (the company will continue to prefer leasing); **(iii)** Almost 100% hedging on inputs for the 24/25 harvest, which seems quite assertive to us; **(iv) Negative impacts of El Niño 23/24 exceeded previous expectations**; **(v)** Planting in **Mato Grosso (MT)** suffering beyond normal due to the volatility of the rainy season; **(vi) 2nd crop for cotton should deliver good figures**, accompanied by corn; **(vii)** El Niño affected Bahia (BA), as expected, with a **drop in the 1st crop of soybeans and corn**; **(viii)** Transition from **El Niño to La Niña**: Good times ahead for production; **(ix)** New technologies employed in the field should reduce costs; **(ix) Government Crop Plan for the 24/25 cycle** was announced on the same day as the event, bringing an **increase in resources of +16.5% y/y**, reaching R$475bn; **(xi)** Can demand for **cotton** be impacted with a **soft landing in the US**? We believe so; **(xii)** Does the current scenario point to land acquisitions? Market seems to agree, but SLC disagrees. **Investors raised questions after the event about the strategy of leasing rather than buying land**; **(xiii)** Even with low soybean and corn prices, we expect a **relevant production in the 24/25 harvest**, given the **favorable conditions brought about by La Niña**; **(xiv)** We believe that the prominent dynamics of cotton will persist over the next few months and continue to **partially offset the disappointing figures for soybeans and corn**. However, our perception is that prices are likely to cool down in 2025, and the **low level of cotton hedging in the 24/25 harvest worries us**. **(xv)** In addition, another interesting driver is the company's **cost reduction** and efficiency increase strategies; **(xvi)** We see SLC trading at an **EV/EBITDA 25E** of **6.1x** vs. a historical average of 6.7x, **still discounted**, even after the recent rise in the shares value due to the land revaluation. We therefore reiterate our **BUY rating** with a **12M Target Price** of **R$23.50,** with a **upside** of **+23.36%**.

On July 3rd, we attended another edition of **SLC's Investor Day**, affectionately dubbed **Farm Day 2024**, at the **Pamplona farm** in Goiania (GO), which was founded in 1979 and began operations in 1980, growing cotton, corn and soybeans in a **planted area of ~27kha**. At the event, we took part at several presentations by the company's management team, from the operational side, visiting the planting area in loco and demonstrations of new technologies applied to the field.

Valuation and rating. In the current context, with agribusiness producers facing tight margins, we believe it is a **good time to acquire land** and achieve a high IRR on the properties. However, SLC indicated during the Farm Day event that it was prioritizing leasing and growth in the **Asset Light** model. We found out, through rounds of **conversations with investors after the event,** that **many still don't seem to validate the strategy**, given that the company's track record of valuing land is interesting, having made good purchases in the past looking at profitability at opportune moments like this.

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Company

SLCE3 BZ Equity
Buy

Price: R$ 19.05 (04-Jul-2024)
Target Price 12M: R$ 23.50

Regarding the climate panel given at the event, the main message was that the low intensity of **La Niña**, forecast for the **24/25 harvest**, will probably reverse the crop failure that occurred during **El Niño**, which was in force in the **23/24 harvest**. **This reversal should bring favorable scenarios**, which could **increase soybean yields** by **+3.05 bags/ha** (higher than predicted in the trend line, reaching 64.68 bags/ha). Regarding **cotton** figures, we question the durability of the price at the current attractive level. Although we believe that price conditions should remain high in the coming months, there are risks of a **possible slowdown in 2025**. SLC sends considerable shipments of cotton to China, but the destination is mostly the USA. This is because it is common practice for China to make garments and export them to the US, which is the real center of the consumer market. So, the effect of **higher for longer interest rates in the US** can reduce economic activity and create obstacles for demand in local discretionary retail, dampening demand for textile products and lowering the cotton price.

Even with low soybean and corn prices, we expect **significant production in the 24/25 harvest**, given the **favorable conditions** brought about by **La Niña**. We believe that the **positive dynamics of cotton** will persist in the **short term** and continue to help partially offset the **disappointing figures** for **soybeans and corn**, although **cotton price may move downwards in 2025**. In addition, another interesting driver is the **company's cost reduction** and efficiency increase strategies. Finally, we see SLC trading at an **EV/EBITDA 25E** of **6.1x** vs. a historical average of 6.7x, still **a reasonable discount**. We therefore reiterate our **BUY rating** with a **12M Target Price** of **R$23.50,** giving the shares an **upside** of **+23,36%**.

Farm Day 2024

Trends on Biofuels. Mr. Aurelio Pavinato, CEO of SLC, began the event's presentations by commenting on the trends driving the market today. Among them, he mentioned not only global population increase, but also the need for energy transition through biofuels, which **still represent 9% of the world's agricultural production area**, according to the FAO (Food and Agriculture Org. of the UN). Today, combining the USA and Brazil, the data points to 69Mt of soy being used for Biodiesel and HVO (green diesel), corresponding to ~27% of total production. For the next few years, the expected CAGR ranging about +4%.

Mr. Pavinato also pointed out the potential to be unlocked in the **demand for SAF** (Sustainable Aviation Fuel). The volume of SAF in the world today is 1.9bn liters and is estimated to reach 450bn liters by 2050. At the same time, studies point to a reduction of -24% in the use of CAF (Conventional Aviation Fuel), or popularly known as aviation kerosene jet fuel, by 2050. In summary, SLC's expectation is that in the coming decades there will be a growth in world demand for agricultural products and that **Brazil will play a strategic role in supply**, since the increase in Brazilian production will also occur through the expansion of the planted area.

Being Asset Light is still the focus, buying land is in the background. Over the last 5Y, SLC's ROE has fluctuated around ~22% and the company expects to deliver a similar ROE going forward at ~20%. Although the expectation is for a slight fall, we still consider this to be a very mature profitability level. As a cause of this plan, Mr. Pavinato highlighted the company's Asset Light growth. Although we had already indicated in recent reports that the current scenario would be favorable for larger players to buy land, the company will maintain the pace of transition to an increasingly Asset Light model.

Even though we are aware that small and medium-sized producers have tight margins, which would lead them to resort to selling properties in order to guarantee some level of cash flow generation, directing bargaining power to larger producers, who have more working capital to withstand pressure on commodity prices, SLC still believes strongly in focusing on operations through leased land. Therefore, the company seemed to place less emphasis on taking advantage of this opportunity to buy land, preferring the artifice of leasing.

SLC has been significantly increasing the percentage of land leased. In the 06/07 harvest, the percentage of leased land was 8.5%, while in the last harvest, 23/24, this amount (leases and JVs) exceeded 61%. As an example of an operation that would support the Asset Light movement, the company has already announced for the 24/25 harvest the doubling of Fazenda Pioneira, through a joint venture (JV) with Agro Penido. The size of the farm will increase to 39kha (2x more than before the partnership), and could reach 64kha (or 3x more), by intensifying the 2nd harvest over the next few years.

Almost 100% hedge on inputs for the 24/25 harvest. During the event, SLC confirmed that it had already purchased the vast majority of the inputs needed for the 24/25 harvest, locking in prices for 100% of potassium chloride requirements, 97% of nitrogen, 92% of phosphates and 85% of pesticides. We believe that the company was fortunate to consider more opportunistic moments of negotiation, which generated a lower cost for the 24/25 harvest than the 23/24 cost. This will probably help offset the negative effect on the margin of the price discount we have seen over the last year.

The negative impacts of El Niño 23/24 exceeded previous expectations. In the 23/24 crop year, we understand that El Niño brought out a very challenging context for the company's production, similar to the 15/16 harvest (one of the worst in terms of productivity in recent cycles). This dynamic ended up contradicting the initial outlook given by SLC itself at last year's Farm Day, given expectations of milder effects at the time. We believe that this divergence can be explained by the territorial regions affected in this El Niño cycle vs. previous years. For the 23/24 harvest, in addition to affecting the northeast of the country, we also see repercussions in Mato Grosso (MT), which is the company's most productive region and usually doesn't suffer from climate disruption, since the last occurrence was ~40 years ago.

Why has Mato Grosso suffered more than usual this cycle? With an intense volume of rainfall in September 2023, producers brought forward soybean planting, anticipating the normal schedule in the face of the El Niño weather event. This was followed by 3M of almost no rain at all. This context affected the company's soybean production, with a drop of -34% y/y in the state of Mato Grosso (MT). SLC's average replanting rate is 2%, with very limited losses. However, replanting in the 23/24 harvest was 9% (indicating a loss rate ~4.5x higher than normal). During the months of January and February 2024, there was a gradual return of the rainfall index in Mato Grosso (MT), which although still below the historical average for a cycle outside of El Niño, as it is already a period in which the volume of rainfall is seasonally higher, this seems to have helped ease the critical conditions of the high level of replanting.

High volatility in rainfall. Even with the gradual return of the rains in the first 2M of the year, in March (an important month for cotton), the level of rainfall regressed again. In April, however, rainfall was at high levels, even above the historical average (179mm vs. 149mm average). This led to an improvement in field productivity, since the soil was at full capacity, resulting in good cotton filling.

2nd crop cotton should deliver good numbers, along with corn. Although there was a low volume of rain in May (only 5mm vs. 50mm of the historical average), cotton planting should still be satisfactory for the 2nd crop harvest. If the rain had come in fuller, there would have been up to 60 arrobas of additional cottonseed (1arroba =15kg). In the case of corn, the condition was also positive.

El Niño affected Bahia, as expected. Bahia (BA) faced difficulties in planting crops, as rainfall in October, November and December was lower for the seasonal period in the face of the climatic event, with the region experiencing drought and leading to the replanting of soybeans and cotton. This is not surprising, since in El Niño years we believe it is normal for the Northeast to experience disruptions in the face of little rainfall.

Losses in the 1st soybean and corn crops. Also in Bahia (BA), rain volume intensified in April, which caused the cotton to rot to a greater extent than expected. Difficulties in field management also affected soybean planting, causing production in Bahia (BA) to fall by around 8%. For corn harvest, SLC had its planting area reduced, with more than 40% of this crop being planted in Maranhão. The difficulty encountered was the delay in rainfall due to El Niño. As a result, we will probably see a drop in corn productivity in the current harvest.

Transition from El Niño to La Niña: Good times ahead for production. SLC's projection presented at Farm Day shows a robust scenario for the 24/25 harvest, which will be exposed to a low-intensity La Niña, so being very welcome in reversing the previous situation of crop failures. We believe that the transition from El Niño to La Niña will help soybean planting, through more dispersed precipitation, with an elastic rainfall index towards the end of the 2nd crop cycle.

New technologies presented during the event. Among the technologies presented to analysts and investors at this year's Farm Day, we found some that demonstrated SLC's ability to cut costs. Among them, we highlight the significant reduction in the refueling of planters, which today takes between 34-37 minutes. Through the case presented to us, the company hopes to reduce the process time to 12-15 minutes (almost half). Another innovation brought up by the operational directors was the remote monitoring of carbon sequestration in green areas, using calculation technology to measure the volume of carbon footprints and reduce emissions, as well as obtaining carbon credits to be traded.

Brazilian government's Crop Plan cycle 24/25. Coincidentally, on the same day as the event, Brazilian authorities announced the 24/25 cycle Crop Plan, marking up R$475bn (+16.5% y/y) available to finance agriculture and livestock in Brazil until June next year, presenting a solid extension of figure. The plan offers more attractive credit lines than those of the traditional financing market and divides the resources into two groups: **(i)** R$400bn (84%) for large and medium-sized corporate farmers, and **(ii)** R$75bn (16%) for family farmers.

The total amount for this plan could reach R$508bn with the possible issue of LCA (Agribusiness Bonds), issued by financial institutions to complement the CPR (Rural Product Notes), which in turn are securities representing promises to deliver agribusiness products. The interest rates for costing and commercialization are 8% per year for producers linked to Pronamp (National Support Program for Medium-sized Rural Producers), a BNDES tool that channels federal funds to the agricultural sector, while investments have rates that vary between 7% and 12% per year, depending on the program.

Our Take on SLC

Could cotton suffer demand impacts from a soft landing in US? As we discussed at the beginning of the report, SLC sells most of its cotton to China, but the main center of demand is the US, since China uses cotton to make clothing and exports it to the US. With the US economy cooling down, there is a potentially imminent undesirable eventuality of seeing products derived from the textile industry losing demand in 2H24. Considering a delay until the effects appear at the beginning of the chain, it may be some time before we see the commodity, which is attractively priced, to fall. For us, the likelihood of this effect of a slowdown in cotton price should occur in 2025.

Does the current scenario point to land acquisition? SLC disagrees. Small and medium-sized rural producers have tight margins in the face of a negative cycle for various agricultural commodities, which often leads to a desire to sell assets in order to boost cash flow generation and reduce working capital. In this context, everything suggests that, at the moment, it would be a positive sign for the investment thesis of large producers to make offers for rural land.

This momentum occurs because bargaining power tends to shift in the direction of the large producer, who has more access to different ways of financing and have more capacity to withstand persistent negative price cycles.

In other words, there is an opportunity to buy land with high productive potential under attractive payment conditions. However, as mentioned earlier, SLC strongly believes in asset-light growth and prioritizes leasing land (and not buying it), reiterating that company needs to focus on the operation (and not on the real estate arm) and that it has a financial cycle of 260 days in working capital. In conversations we had with investors after the event, the strategy raised questions among the market as to whether it was in fact appropriate.

Migration from El Niño to La Niña should bring good results. The mild La Niña, which will feature in the 24/25 harvest, should lead to favorable scenarios. The company hasn't released any guidance, but it has shown the trend line for soybean bag yields, which points to 64.68 bags/ha, up to an increase by +3.05 bags/ha as a result of La Niña.

La Niña, the million-dollar baby. Even with low soybean and corn prices, we expect significant production in the 24/25 harvest, given the **favorable conditions** brought about by **La Niña**. We believe that the **positive dynamics of cotton** will persist **over the coming months** and continue to partially offset the **disappointing figures for soybeans and corn.** However, we also see a **price reversal trend as likely by 2025**, as high interest rates in the US reduce the impetus for discretionary retail consumption and this situation trickles down to the production chain, reducing demand and **cooling the cotton price**. Therefore, we are concerned about the **low advance in cotton hedges** presented by SLC for the **24/25 harvest**.

However, we conclude that the balance sheet shows more positive than negative signs for the crop outlook as a whole. Another interesting driver is the company's strategies for reducing costs and increasing efficiency, mainly through the use of technology in the field. Finally, we see SLC trading at an **EV/EBITDA 25E** of **6.1x** (vs. 6.7x historical average), **which seems discounted,** even in light of the stock's rise after Delloite's land revaluation. We therefore reiterate our **BUY rating** with a **12M Target Price** of **R$23.50**.

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under Review	Under review	**5%**

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