SLC AGRICOLA

2Q24 Review: Staunching the wound with cotton

LatAm Agribusiness

Main takeaways:

(i) Net revenue of R$1.35bn (-1.1% vs. Genial Est.), down -6.4% y/y and -30.9% q/q; **(ii) EBITDA** of R$258.1mn; (+1.2% vs. Genial Est.), a **sharp contraction** of -53.4% y/y and -63.3% q/q; **(iii) Net income** of R$321.4mn (-3.2% vs. Genial Est.), down -7.8% y/y; but up +40.4% q/q; **(iv) El Niño** brought **undesirable impacts** on soybeans, down -7.8% y/y, but up +40.4% q/q; **(v)** Corn showed slightly more resilient figures in the face of climate adversity; **(vi) Cotton sustained results**; **(vii)** August **USDA report**: reduction in **cotton** supply; **(viii)** we believe that in the medium term the price of cotton will slow down; **(ix)** August **USDA report**: **soybean** production increases; **(x)** Scenario points to land acquisition? SLC has a different strategy (leasing). **Some investors question the stance**; **(xi) La Niña**, if it occurs smoothly, should lead to **better results**; **(xii)** We believe that the positive signals will bring a gain for the shares through **more favorable harvests ahead**. In addition, we pay attention to other drivers linked to the **cost reduction** and efficiency increase that the company has been implementing. Therefore, trading at an **EV/EBITDA 25E** of **5.7x** (vs. a historical average of 6.7x), showing a discount, we reiterate our **BUY rating** with a **12M Target Price** of **R$23.50** and an **upside** of **+29.12%**.

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Company

SLCE3 BZ Equity
Buy

Price: R$ 18.20 (15-Aug-2024)
Target Price 12M: R$ 23.50

SLC reported its **2Q24 figures yesterday**, August 14. We judge the results to be **weaker**, given the **fall in grain prices** (soybeans and corn), despite a **good performance in cotton**. The company reported **net revenue** of **R$1.35bn** (-1.1% vs. Genial Est), representing a drop of -6.4% y/y and -30.9% q/q. **Adjusted EBITDA** reached **R$258.1mn** (+1.2% vs. Genial Est.), a reduction of -53.4% y/y and -63.3% q/q, resulting in a **margin of 19.1%**, which means a **contraction** of **-19.2p.p y/y**. **Net income** was **R$321.4mn** (-3.2% vs. Genial Est.), a reduction of -7.8% y/y despite a rise of +40.4% y/y, reaching a **net margin** of **23.8%** (+12.08p.p q/q; -0.36p.p y/y).

Table 1. Income Statement SLC (2Q24 vs. Genial Est.)

(R$ Millions)	2Q24 Reported	2Q24E Genial Est.	% R/E	1Q24 Reported	% q/q	2Q23 Reported	% y/y
Net Revenue	**1.352**	**1.367**	**-1,1%**	**1.957**	**-30,9%**	**1.444**	**-6,4%**
COGS	(1.077)	(1.082)	-0,4%	(1.245)	-13,4%	(926)	16,4%
Adjusted EBITDA	**258**	**255**	**1,2%**	**704**	**-63,3%**	**570**	**-54,7%**
EBITDA Margin (%)	19,1%	18,7%	0,44p.p	36,0%	-16,89p.p	39,4%	-20,35p.p
EBIT	**675**	**658**	**2,6%**	**499**	**35,4%**	**644**	**4,8%**
EBIT Margin (%)	50,0%	48,1%	1,82p.p	25,5%	24,48p.p	44,6%	5,37p.p
D&A	65	62	4,9%	60	7,9%	52	25,3%
Financial Result	(224)	(211)	6,4%	(190)	17,9%	(173)	30,0%
Net Income	**321**	**332**	**-3,2%**	**229**	**40,4%**	**349**	**-7,8%**
Net Margin (%)	23,8%	24,3%	-0,51p.p	11,7%	12,08p.p	24,1%	-0,36p.p

Source: SLC, Genial Investimentos

2Q24 Review

El Niño has had undesirable impacts on soybeans. The El Niño phenomenon has brought significant challenges and impacts on the production and marketing of soybeans and corn. Soybean production suffered a significant drop in productivity, reaching only 3,276kg/ha, a reduction of -15% vs. Initial Genial Est. and -17% vs. SLC Budget, decreasing -16.1% vs. 22/23 harvest. This reduction in productivity resulted in a -27.4% y/y drop in the volume of soybeans invoiced, totaling 259Kt, and a -43.2% y/y drop in net revenue from the crop, which was strongly impacted by lower prices and higher unit costs. As a result, the unit gross result for soybeans fell dramatically, with a reduction of -94.6% y/y. The change in the fair value of soybean biological assets was impacted by adverse weather conditions, resulting in a negative markdown. Soy showed a negative variation of -R$156.2mn in 1H24, in contrast to a positive variation of +R$813.9mn in 1H23.

Corn showed more resilient figures in the face of climate adversity. In the case of corn, although productivity was more resilient, reaching 7,046kg/ha, it still registered -7% vs. SLC's budget for the 23/24 harvest, coming in line with our estimates, due to the irregular distribution of rains and heat waves, especially in the state of Maranhão. The invoiced volume of corn showed a marginal increase of +2.7% y/y, totaling 32.3Kt. However, net revenue from corn fell -8.5% y/y, reflecting the drop in commodity prices and the increase in unit costs, which resulted in a -67.1% y/y drop in gross unit income.

Cotton sustaining results. In 2Q24, SLC showed a positive performance in cotton production and shipments. There was a significant increase of +58.9% y/y in the volume of cotton invoiced, totaling 81.4Kt. In addition, the gross unit result for lint cotton was +15.4% y/y, driven by a -12.0% y/y drop-in unit cost due to the high productivity achieved in the 22/23 harvest. These results were able to partly offset the losses seen in other crops, such as soybeans.

The company also adjusted its commodity hedge for cotton, with 58.8% of production hedged to date. Although we maintain a bearish outlook for soybeans and corn, we remain optimistic about cotton in the short term, due to **(i)** limited supply in Texas (TX-USA), which may still provide support even if demand for textile products slows down in the USA; **(ii)** an Asian industry operating rate higher than the historical average; **(iii)** a still high level of cotton imports by China, although the latest data shows a slight slowdown for 3Q24. We have previously commented that we believed there would be a tendency for cotton prices to remain at these more attractive levels in the short term in the event of production losses in Texas due to the impacts of La Niña. The latest USDA report already reflected this trend.

Our Take on SLC

August USDA report: reduction in cotton supply. The USDA revised downwards its cotton estimates for August 24/25 in the US, highlighting a significant reduction in planted area, production, exports and ending stocks vs. June. Production was reduced to 15.1m bales, due to lower planted area and an increase in the abandonment rate. Globally, production and consumption were also down, particularly in India and China. As a result, global closing stocks were revised downwards and the “A” index, which reflects world prices, was adjusted to US$0.81/pound. These revisions indicate a scenario of tighter supply and possible support for cotton prices in the short term.

Even so, we believe that in the medium term the price of cotton will slow down. Although SLC allocates most of its cotton production to China, the final destination for demand allocation is usually the US, as China uses it to manufacture clothes that are exported to the US market. With an economic slowdown in the US already underway, there is a risk that demand for textile products will decrease in 2H24 or 2025. Given the time it takes for these effects to propagate along the production chain, it may take some time before the price of cotton, currently at attractive levels, starts to fall. In our view, this downward movement in cotton prices is more likely to materialize in 2H25.

August USDA report: soybean production increases. Global soybean production was revised upwards, with increases in the US, Ukraine, Russia, India and Benin. Imports, meanwhile, were directed towards countries in Europe, Iran and Turkey. Global soybean ending stocks rose to 134.3Mt, mainly due to increased reserves in the US, China and Argentina, despite a reduction in stocks in Brazil. In addition, the revisions to the figures for China and Brazil stem from changes in trade during the year 23/24, with higher imports by China and a strong pace of exports from Brazil. With a greater supply of soybeans on the world market, the impact on prices is likely to be downward pressure.

Scenario points to land acquisition? SLC has a different strategy. The current moment indicates that, with producers' margins still tight in the face of a negative commodities cycle (corn and soy), it would be ideal for large producers like SLC to acquire land from smaller ones. Medium and small producers usually have a harder time during negative cycles, with working capital under pressure as they extend the harvest in the expectation that prices will improve. Faced with this scenario, the greater urgency to make cash flow ends up leading these smaller producers to put a portion of their assets up for sale, negotiating them at a lower price than usual.

However, SLC has increasingly believed in asset-light growth and has prioritized land leasing, reiterating that it needs to focus on the operation (and not the real estate arm) and that it has a financial cycle of 260 days in working capital. This goes in the opposite direction of taking advantage of the moment to buy productive land at lower prices. As a result, some investors are questioning whether this is really the best strategy.

La Niña should lead to better results. We believe that a mild La Niña will appear in the 24/25 harvest. If the intensity is indeed mild, we believe that the scenario will be favorable. At Farm Day, SLC showed a trend line for soybean yields, which points to **64.68 bags/ha**, which could increase by **+3.05 bags/ha** as a result of La Niña.

Staunching the wound with cotton. Even with low prices for soybeans and corn, we expect **significant production in the 24/25 harvest**, given the **favorable conditions brought about by La Niña**. We believe that the **favorable dynamics of cotton will persist over the coming months** and will continue to help **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 down the price of cotton**.

However, we believe that the positive signs will bring a gain for the shares through more favorable harvests ahead. In addition, we pay attention to other drivers linked to the **cost reduction** and efficiency increase that the company has been implementing. Therefore, trading at an **EV/EBITDA 25E** of **5.7x** (vs. a historical average of 6.7x), showing a discount, we reiterate our **BUY rating** with a **12M Target Price** of **R$23.50** and an **upside** of **+29.12%**.

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