genial Equity Research

SLC AGRICOLA

3Q24 Preview: USA elections offer opportunities and risks

LatAm Agribusiness

Main takeaways:

(i) We believe that cotton will continue to help offset the weaker performance of soybeans and corn in the short term. **(ii)** We comment in the "Our Take" section (at the end of the report) on **how the Trump administration's US election decision could impact the Brazilian agricultural sector**. There is a potential gap for Brazil to fill to sell even more soybeans to China, while demand may slow down. **(iii)** On the fundamentals side, SLC is trading at an **EV/EBITDA 25E** of **5.6x**, (vs. historical average of 6.7x) representing a discount, which we consider attractive. We therefore reiterate our **BUY rating**, with a **cut** in our **12M Target Price** to **R$22.00** (vs. R$23.50 previously) and an **upside** of **+25.93%**. The cut was made as we updated our model for **commodity prices**, with soybeans indicating a lower level than we expected at this point.

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Company

SLCE3 BZ Equity
Buy

Price: R$ 17.47 (07-Nov-2024)
Target Price 12M: R$ 22.00

SLC will release its **3Q24 results** on **November 12**, after the market closes. For the quarter, we maintain a **cautious short-term outlook**, with emphasis on the **(i)** impact of the agricultural commodities scenario, especially grains. **On the negative side**, soybean and corn prices remain under pressure due to **(ii)** the increase in global supply and stocks, reinforced by recent USDA revisions. This scenario poses a significant challenge to SLC's consolidated performance, given that **(iii)** future curves indicate a downward trend for both commodities.

On the positive side, cotton continues to be a **point of resilience**, partially offsetting pressures in other areas. The company maintains its currency hedge for 86% of cotton sales for the 23/24 harvest, at an average rate of R$5.42, which provides **(i)** predictability amid market volatility. However, we project a possible price reversal in 2025, considering the **(ii)** economic slowdown in the US, with the FED starting an interest rate cut cycle and the **(iii)** potential impact on textile exports to this market.

Table 1. Income Statement SLC (3Q24 Genial Est.)

(R$ millions)	3Q24E Genial Est.	2Q24A Reported	% t/t	3Q23A Reported	% a/a
Net Revenue	**1.643**	**1.352**	**21,5%**	**1.648**	**-0,3%**
COGS	(1.134)	(1.077)	5,3%	(1.188)	-4,6%
Adjusted EBITDA	**445**	**258**	**72,5%**	**492**	**-9,6%**
EBITDA Margin (%)	27,1%	19,1%	8p.p	29,9%	-2,77p.p
EBIT	**403**	**675**	**-40,3%**	**415**	**-2,9%**
EBIT Margin (%)	24,5%	49,9%	-25,4p.p	25,2%	-0,65p.p
D&A	42	65	-35,4%	(57)	-173,7%
Financial Result	(350)	(224)	56,3%	(191)	83,2%
Net Income	**44**	**321**	**-86,3%**	**167**	**-73,7%**
Net Margin (%)	2,7%	23,7%	-21,06p.p	10,1%	-7,46p.p

Source: SLC, Genial Investimentos

3Q24 Preview

In 3Q24, we estimate total **Net Revenue** of **R$1.6bn Genial Est.**, a slight drop of -0.3% y/y. We project an **adjusted EBITDA** of **R$445mn Genial Est**., down -9.6% y/y, equivalent to -2.77p.p. y/y compression in margin, which should thus reach 27.1%. Finally, we project a **Net income** of **R$44mn Genial Est**. (-73.7% y/y).

Challenges persist with the fall in Soybean and Corn prices. We believe that the situation remains challenging for soybeans and corn, with a series of factors that should negatively impact this quarter's consolidated operating result. Among them, we highlight: **(i)** a probably lower gross result for soybeans, impacted by the drop in unit prices and by a strategy of partially retaining the invoiced volume for the next quarter, which reflects an attempt to mitigate the effects of a shrinking grain market; **(ii)** in corn, we estimate a -20% y/y drop in invoiced sales and a -23% y/y drop in price, both factors that should put pressure on revenue and margins. In addition, we believe that the company will adopt **(iii)** a strategy of postponing the sale of corn, leaving ~320Kt to be invoiced in 4Q24, seeking a recovery in prices.

Cotton offers partial relief. In cotton, although we expect lower prices y/y, we believe that it will continue to play an important role in partially offsetting the weak results of soybeans and corn, with ~86% of sales for the 23/24 harvest already locked in at a realized price of R$82.04 and an average USD/BRL exchange rate of R$5.42, which may ensure some predictability for revenue for this commodity in particular. We note that the weather conditions that prevailed during the quarter, with moderate rainfall in the Midwest and Northeast, favored the development of crops without major deviations in productivity. We would point out that although planting seems to have started with a slight delay due to the slower onset of rains in September, precipitation normalized in October, allowing progress to be made within the ideal window.

Our Take on SLC

Challenging scenario in the short term, with a cautious strategy for Soybeans and Corn. Looking ahead, we don't expect a significant recovery in the short term for soybean and corn commodities. The latest USDA report reinforces our bearish bias for soybeans by revising global production upwards, with significant increases in the US, Ukraine, Russia and India, reflecting an expansion in international supply. This increase in production, added to the rise in global stocks, which now stand at 134.3Mt, is the result of higher reserves in the US, China and Argentina, while Brazil showed a slight reduction in its final stocks. In the case of corn, the company's strategy of holding back part of its sales for the next quarter, in search of more favorable prices, may offer some potential relief in 4Q24, especially if unexpected climatic factors impact global production.

Even with increased productivity for the 24/25 harvest, margins are likely to come under pressure in the short term. On the one hand, the return on corn production for the 24/25 harvest is expected to recover, as the **(i)** El Niño effect dissipates; **(ii)** productivity increases; and **(iii)** the arrival of La Niña and its adverse weather conditions begin to prevail. On the other hand, we are still seeing a **(i)** high level of stocks (132.4Mt; +4% y/y), coupled with a **(ii)** low pace of negotiations, with **(iii)** potentially reducible international demand. In addition, **(iv)** we consider a crop failure in Argentina or southern Brazil to be unlikely for 24/25, and this leads to a lack of certainty in positive price support. Therefore, our base scenario is that the increase in productivity will not be translated into a significant expansion in margins in the short term.

US weather indicates restricted cotton supply. The latest USDA report highlighted a significant reduction in cotton supplies for the 24/25 harvest, with **(i) a** decrease in planted area; **(ii)** an increase in the abandonment rate in the USA; **(iii)** a possible recovery in demand for textile products as the global scenario stabilizes; **(iv)** expectations that lower interest rates in the USA may encourage industrial consumption; and **(v)** a potentially challenging climate scenario in Texas, the largest cotton producer in the USA. We believe that the revised production to 15.1M bales reflects a scenario of tighter supply, with downward revisions also in global production and consumption, mainly in India and China. As a counterpoint, although prices are still at lower levels y/y, SLC's currency hedge already locked at R$5.42 should mitigate some of the impact, offering some predictability in revenues.

In line with our opinion of months ago, we maintain the view that demand for cotton may weaken. Despite this scenario of restricted supply and price support in the short term, as opposed to the horizon view mentioned above, we continue to have a cautious outlook for the medium term due to the combination of variables that are sensitive to cotton's results. The main thermometer is the North American market, via textile demand from China. Although the US is on a path towards an imminent interest rate cut, the **(i)** irreducible American economic slowdown linked to the **(ii)** implicit risks of the presidential elections and their tariff reverberations on the Chinese economy, should impact demand until 2H25. We believe that this move could limit price support in the medium term, considering that the production chain takes some time to absorb the effects of reduced demand. In our view, the cotton price scenario could show a more noticeable downward trend over the course of 2025.

Impact of the US elections: Opportunities vs. challenges for the Brazilian agricultural sector. The US presidential elections are likely to have significant implications for the global agricultural sector, with direct effects for Brazil. We analyze key issues, such as protectionism through tariff barriers, which could affect the trade balance and, consequently, Brazil's competitive position as a strategic supplier. With the potential breakdown of the trade relationship between the US and China under the Trump administration, we see Brazil's reaffirmation as the main exporter of soybeans and corn to China **as an opportunity**.

As China seeks to diversify its imports, the biggest beneficiary would be Brazil, which already exports ~70% of the volume of soybeans consumed in China, with the US being the second largest exporter to the region.

From Brazil's point of view, we can see that this year ~64Mt of soybeans have already been shipped to China, representing 76% of Brazil's soybean exports. In addition, the devaluation of the BRL/USD has increased the competitiveness of Brazilian products on the foreign market. On the other hand, **as challenges**, we highlight that a tariff embargo could have a negative impact on China's GDP, which is highly dependent on exports, reducing the country's average income and, consequently, domestic consumption. This economic weakening would put negative pressure on demand for soybeans, generating a bearish effect on global prices.

Cotton as partial relief amid pressure on corn and soybeans. In the face of low soybean and corn prices, we continue to expect significant production in the 24/25 harvest, driven by the favorable conditions that La Niña may bring. We believe that cotton will continue to play an important role, supporting SLC's margins despite the pressure on other crops. The latest USDA report reinforces a tight supply scenario for cotton, suggesting support for prices in the short term. However, our medium-term view is cautious, considering a potential reversal in 2025, as the economic slowdown in the US and possible tariff repercussions limit textile consumption, impacting demand for cotton and potentially pressuring prices.

In addition to market conditions, we would highlight SLC's ongoing efforts to reduce costs and operational efficiency, which position it in a resilient position in the current scenario. The company remains committed to its *asset light* strategy, prioritizing leases over land purchases, but open to specific strategic acquisitions that can add value to the portfolio. We see SLC trading at an **EV/EBITDA 25E** of **5.6x**, (vs. historical average of 6.7x) representing a discount, which we consider attractive. We therefore reiterate our **BUY rating**, with a **cut** in our **12M Target Price** to **R$22.00** (vs. R$23.50 previously) and an **upside** of **+25.93%**. The cut was made as we updated our model for commodity prices, with soybeans indicating a lower level than we expected at this point.

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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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