genial | Equity Research

SLC AGRICOLA

3Q24 Review: Support made of cotton

LatAm Agribusiness

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Company

SLCE3 BZ Equity
Buy

Price: R$ 17.42 (12-Nov-2024)
Target Price 12M: R$ 22.00

Main Takeaways

(i) Net revenue of **R$1.63bn** (-0.7% vs. Genial Est.), up 20.6% q/q and down -1.0%y/y; **(ii) EBITDA** of **R$463mn**, down -5.9% y/y and up +79.5% q/q; **(iii) Net loss** of **R$17mn**, down -105.3% q/q and -110.2%y/y; **(iv)** Scenario remains challenging for soybeans and corn; **(v) Cotton provides partial relief with gross result of R$307.8mn; (+28.8% y/y)**; **(vi)** Questionable **CAPEX** allocation with expansion of planted area; **(vii) Weak FCF generation**, coming in at **R$147.5mn** (-74.6% y/y); **(viii**) The latest USDA report showed a significant reduction in cotton supply for the 24/25 crop. Price tends to remain high in the short term;**(ix**) SLC is trading at an **EV/EBITDA** of **5.6x 25E**, below the historical average of **6.7x**, which represents an attractive discount; **(x)** We reiterate our **BUY rating**, with a **12M Target Price** adjusted to **R$22.00**, with **upside** of **+26.29%**

SLC reported its **3Q24** figures **on November 12**, after the market closed. The results showed **signs of weakening**, linked to **soybeans and corn**, impacted by the **drop in productivity, planted area and prices of these crops**, although **cotton offered some support.** Net revenue was R$1.6bn (-0.7% vs. Genial Est.), up +20.6% q/q in the face of the harvest period and down -1.0% y/y, already considering the seasonal effect. **Adjusted EBITDA** reached **R$463mn** (+4.0% vs. Genial Est.), an increase of +79.5% q/q, but a slight contraction of -5.9% y/y, resulting in a **margin of 28.4%** (+9.3p.p. q/q; -1.47p.p. y/y), demonstrating operational sustainability and a business profitability margin above that already priced in by consensus, even in a challenging environment. In the bottom line, the company reported a **Loss** at **-R$17mn** (-138.6% vs. Genial Est.).

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

(R$ millions)	3Q24A Reported	3Q24E Genial Est.	% R/E	2Q24A Reported	% q/q	3Q23A Reported	% y/y
Net Revenue	**1.631**	**1.643**	**-0,7%**	**1.352**	**20,6%**	**1.648**	**-1,0%**
COGS	(1.194)	(1.134)	5,3%	(1.077)	10,9%	(1.188)	0,5%
Adjusted EBITDA	**463**	**445**	**4,0%**	**258**	**79,5%**	**492**	**-5,9%**
EBITDA Margin (%)	28,4%	27,1%	1,3p.p	19,1%	9,3p.p	29,9%	-1,47p.p
EBIT	**73**	**403**	**-81,9%**	**675**	**-89,2%**	**415**	**-82,4%**
EBIT Margin (%)	4,5%	24,5%	-20,05p.p	49,9%	-45,45p.p	25,2%	-20,71p.p
D&A	(153)	(42)	264,3%	(65)	135,4%	(57)	168,4%
Financial Result	(212)	(350)	-39,4%	(224)	-5,4%	(191)	11,0%
Net Income	**(17)**	**44**	**-138,6%**	**321**	**-105,3%**	**167**	**-110,2%**
Net Margin (%)	-1,0%	2,7%	-3,72p.p	23,7%	-24,78p.p	10,1%	-11,18p.p

Source: SLC, Genial Investimentos

3Q24 Review

Soybeans disappoint less. The results were generally close to our expectations, confirming the challenging scenario we had projected for soybeans and corn. The gross result for soybeans was pressured by the continued fall in unit prices and the lower productivity of the 2023/24 harvest, in line with expectations of a weaker performance. As anticipated in the preview, although the volume invoiced y/y expanded (+98% y/y), we believe that the company has adopted a strategy of partially withholding soybean shipments for the next quarter, seeking to mitigate the effects of a grain market with retracted prices.

Corn disappoints more... The negative highlight is corn. Our estimates were confirmed, with a -41.4% y/y drop in invoiced sales and a -23% y/y drop in the average price. This reduction affected margins a little more intensely than we expected, leading the company to postpone invoicing of ~320Kt to 4Q24, in an attempt to capture a possible more favorable price adjustment. This decision to postpone and the pressures on corn prices would be justified by an environment of abundant global supply and rising inventories, as indicated by the latest USDA reports.

Cotton offering partial relief. Plume cotton recorded a gross result of R$307.8m (+28.8% y/y), partially sustaining the company's performance in the face of pressure from other crops. This improvement was favored by both the reduction in unit cost (-5.2% y/y) and the increase in invoiced volume (+47.2% y/y), which partially offset the drop in unit sales price (-7.9% y/y), keeping cotton as an important buffer against the negative effects of adverse weather on soybeans and corn. As stated in our preview report, SLC kept ~86% of its 2023/24 crop sales hedged, at an average price of R$82.06 and a USD/BRL exchange rate of R$5.42, ensuring some predictability to its invoiced quantity. We note that weather conditions, with moderate rainfall in the Midwest and Northeast, sustained productivity in line with our estimates, even with a slight delay in planting. Cotton thus provided the expected support for results, despite lower prices limiting its contribution to the quarter's consolidated figures.

Our Take on SLC

FCF strong deceleration and CAPEX at questionable level. The generation of **FCFE** amounted to **R$147.5m** (-42% vs. Genial Est.), with a deceleration of -74.6% y/y. This result is explained by multiple factors, including **(i)** lower soybean and corn productivity in the 2023/24 harvest (-16.4% y/y), intensified by the El Niño phenomenon, and **(ii) strategic CAPEX** to expand the planted area in the **24/25 harvest** (R$322.3mn vs. R$128.7mn previously). However, from an investor's point of view, we believe that this expansion of the planted area may be questionable, especially in a context of **relative abundance of supply in the market**, which maintains pressure on commodity prices and limits profitability.

A cautious strategy for soybeans and corn. For the coming periods, we do not anticipate a significant recovery in the prices of soybean and corn commodities. The latest USDA report reinforces our cautious outlook for soybeans, with an upward revision in global production, including substantial increases in the US, Ukraine, Russia and India, which expand supply on the international market. This higher production, coupled with the increase in global stocks - now at 134.3Mt-, reflects an increase in reserves in the US, China and Argentina, while Brazil showed a slight reduction in its final stocks. In the case of corn, we believe that the company's strategy of postponing part of its sales to the next quarter, in order to capture more favorable prices, may provide some potential relief in 4Q24, especially if unexpected weather events impact global production.

Margins under pressure in the short term, despite the expected increase in productivity for the 24/25 harvest. Although corn production returns are expected to recover for the 24/25 harvest, this forecast is conditional on factors such as **(i)** the dissipation of the El Niño effect, **(ii)** increased productivity, and **(iii)** the onset of adverse weather conditions brought on by La Niña. However, elements of pressure should persist: **(iv)** global stocks remain high, at 132.4Mt (+4% y/y), **(ii)** the pace of negotiations remains low, and **(v)** there is a potential downturn in international demand. In addition, we consider a crop failure in Argentina or southern Brazil to be unlikely for 24/25, which reduces the expectation of positive support for prices. Therefore, our basic view is that, although the increase in productivity is a reality, it should not translate into a significant expansion in margins in the short term.

US Weather Indicates Tight Cotton Supply. The latest USDA report showed a significant reduction in the supply of cotton for the 24/25 harvest, highlighting factors such as: **(i) a** reduction in the area planted; **(ii)** an increase in the abandonment rate in the USA; **(iii)** a possible recovery in demand for textile products, in line with the stabilization of the global scenario; **(iv)** expectations that a lower interest rate in the USA will encourage industrial consumption; and **(v)** challenging weather conditions in Texas, the USA's largest cotton producer. With production revised to 15.1 million bales, the tighter supply is evident, accompanied by downward revisions in global production and consumption, especially in India and China. As a counterpoint, despite prices remaining at lower levels year-on-year, SLC's currency hedge, set at R$5.42, should mitigate some of the impact, providing greater predictability in revenues.

Divergent view: Demand for cotton may weaken in the medium term. Despite a scenario of restricted supply and possible price support in the short term, we maintain a cautious outlook for the medium term due to sensitive variables impacting the cotton market. Our main thermometer is the North American market, with a focus on textile demand from China. Although the US is on a path towards a probable interest rate cut by the Federal Reserve, **(i)** the persistent US economic slowdown, combined with **(ii)** the risks associated with the presidential elections and their potential impact on trade tariffs with China, should restrict demand until the second half of 2025.

This move could limit price support in the medium term, especially considering the time needed for the production chain to absorb the effects of reduced demand. In our view, cotton prices could show a sharper downward trend throughout 2025.

Support for cotton amid pressure from corn and soybeans. With **soybean and corn prices at low levels**, we project significant production for the 24/25 harvest, favored by the positive conditions expected with La Niña. **Cotton** should continue to play **a compensatory role** for the company, helping to sustain margins, even in the face of pressure on other crops. The latest USDA report indicates a **tight supply for cotton,** which **could support prices in the short term**. However, we maintain a cautious outlook for the medium term, considering a possible reversal in 2025 with the US economic slowdown and possible tariff barriers, factors that could impact textile demand and put pressure on prices.

In addition to the market context, SLC continues to invest in operational efficiency and cost control, remaining resilient and focused on the asset light strategy, prioritizing leases and evaluating specific strategic acquisitions. Currently, SLC is trading at an **EV/EBITDA of 5.6x 25E** (vs. historical average of 6.7x), which represents an attractive discount. We reiterate our **BUY rating**, with a **12M Target Price** adjusted to **R$22.00** in our preview report, reflecting an **upside of +26.29%.**

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under Review	Under review	**5%**

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