

Q1 2014 Earnings Call

Company Participants

- Marcelo Eduardo Martins, Chief Financial Officer, Investor Relations Officer
- Marcos Marinho Lutz, Chief Executive Officer

Other Participants

- Justin Jenkins, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we'd like to welcome everyone to Cosan's First Quarter of 2014 Results Conference Call. Today with us, we have Mr. Marcos Lutz, CEO; Marcelo Martins, CFO and Investor Relations Officer; and Mr. Guilherme Machado, Investor Relation Manager.

We'd like to inform you that this event is recorded and all participants will be in a listen-only mode during the company's presentation. After Cosan's remarks, there will be a question-and-answer session for industry analysts. At that time, further instructions will be given. (Operator Instructions). The audio and the slide show of this presentation are available through the live webcast at www.cosan.com.br/ir. The slides can also be downloaded from the webcast platform.

Before proceeding, let me mention that forward-looking statements will be made under the Safe Harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of Cosan's management and on information currently available to the company. They involve risks, uncertainties and assumptions, because they relate to future events and therefore depend on circumstances that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions and other pertaining factors could also affect the future results of Cosan's, and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I will turn the conference over to Mr. Martins. You may begin your conference.

Marcelo Eduardo Martins {BIO 16440115 <GO>}

Thanks. Good morning, everyone. I'll like start our presentation with the consolidated pro forma figures for Cosan SA. I just wanted to remind you that we are having our first

quarter -- I mean we're basically releasing the earnings for the first quarter of Cosan SA. But this is also the last quarter of the fiscal year for Raizen. So as we haven't changed the fiscal year for Raizen, we'll compare the first quarter for all businesses expect for Raizen Energia when we're going to talk about the end-year results.

In terms of the net revenues for Cosan SA, we have seen an improvement of 13%, a growth of 13% in the first quarter, reaching BRL9.6 billion, with an EBITDA of the BRL1.02 billion, representing a growth of 13% compared to the first quarter of last year.

EBITDA margin remained stable at 10.7%, and the net income jumped from BRL27 million to BRL256 million in this quarter, presenting growth of over 860%. Just want to call your attention to the fact that -- showing an improvement of over BRL70 million in the financial income, basically as a result of the exchange rate variation between the first quarter of last year and this quarter, as we had a depreciation of the U.S. dollar or an appreciation of the real at the end of the month of March of 2014.

In terms of the different business lines, starting with Raizen Combustiveis which is the fuel switching business for Raizen. We had a growth of 10% in the volume sold, which basically surpass the growth presented by the industry overall as measured by ANP. We had an increase in our market share, a growth of 13% and the sales of the products in the Otto Cycle and 9% in the sale of Diesel.

We had also a growth in our networks that reached almost 5,000 stations at the end of the first quarter. That does not include the 215 new stations we acquired in the south of Brazil through the acquisition of Latina. We had also an increase in number of C-Stores that reached 900 stores at the end of this quarter. Better growth in the volumes sold of 10% and a growth of 8% in the average price. Therefore, net revenues -- we presented of BRL13 billion compared to BRL11 billion in the first quarter of last year.

In terms of the EBITDA and the EBITDA margins, we have an EBITDA of BRL521 million at the end of this first quarter, compared to BRL423 billion in the first quarter of 2013, showing a growth of 23%, with an EBITDA margin of 4%.

Now moving to Raizen Energia, we had for the crop year of 2013-2014, a growth of 9% in the volume of crushed, reaching 61.4 million tons. And in term of the sugar production, we reached 4.5 million tons of sugar produced for the year of 2013-201, representing 8% growth compared to the last year. Ethanol production grew 7%, reaching 2.03 billion liters in the year -- in the crop year 2013-2014.

Energy sold volume went down by 28%, impacted mainly by a reduction in the volume traded in a stock market, that basically means that we had a drop [ph] in the production of -- in a cogeneration of power as a part of the agreements we have signed in the past, but we had a reduction in the volume traded and the spot market during the year of 2013 and 2014. We also saw a reduction in the TSR, a reduction of 2%, when we ended the year at 131 kilos per ton of TSR compared to 133.5 in the first quarter of last year.

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Net revenues improved 12%, reaching 9.5 -- almost BRL9.5 billion with an EBITDA of 2.436, representing a growth of 1% compared to last year and an EBITDA margin of 25.8% compared to -- excuse me, 28.4% in the crop year 2012 and 2013. We had at the end of this first quarter or the last quarter of the crop year, we had a volume of sugar hedged for the year of 2014 and 2015 representing 58% of the overall exports at a leverage price of 18.6 [ph] per pound with an average exchange rate of 2.41, representing a total volume in US\$686 million.

Now moving to Comgas that we released our earnings, recently yesterday, we had our call with the market, we had a volume reduction of 3.8%, mainly as a result of the slowdown in the economic activity in the regionally operation in Brazil, which is the main industrial region in Brazil, when we basically in the quarter sold a volume of 1.3 billion -- sorry, 1.3 million cubic meters. The contribution margin improved, which means that the industrial market represented 68% of the contribution margin of the business.

Net revenues reached BRL1.5 billion, with -- represented by a 5% growth, and it basically means that the margin improves mainly as we managed to reduce our regulatory account as we saw an appreciation in real that impact in the regulatory account was the amount of roughly a BRL60 million, during this quarter and we ended the quarter with the regulatory account balance of BRL283 million which is 8% above the same period of last year. So, it's roughly BRL80 million better and we have basically predicted for this quarter in our budget exercise.

So the EBITDA of Comgas represented BRL342 million with the margin 22.5%, which basically is a growth of 9% compared to the first quarter of the year 2013. And as you note, we also saw a big jump in the volume loaded at the port, representing 2.7 million tons or a growth of 27%. Net revenues grew 24%, reaching BRL208 million, with an EBITDA of BRL93 million with a margin of 44.7%, representing growth of 35% compared to the first quarter 2013.

In terms of the Cosan Lubricants, this is the business that has the performance of those most affected by the economic slowdown in Brazil, and also by the exchange rate appreciation, the appreciation of the U.S. dollar. In previous months, we saw in the month of April, an improvement in the margins as managed; we basically had part of the cost of the products onto the final consumer. But in the quarter, in the first quarter of the year, we still saw the negative impact as they were extremely difficult to pass on 100% of those crop increases to the price. And therefore, we have an EBITDA of 50% lower than the first quarter of last year, basically of approximately (inaudible) compares to BRL48 million in 2013.

For Radar, we saw -- and there is a big jump in net revenue, there is a function of the sale of properties in our portfolio. Those sales represented basically over BRL40 million or much more -- around BRL46 million. And we also saw a reduction in EBITDA as a function of EBITDA spends in the fair market value of the portfolio of the company. This is the time of the year when we basically reassess the portfolio as it's done by either way. And what we saw this year was a reduction in the fair market of BRL21 million compared to a growth of BRL55 million -- sorry, BRL65 million in the first quarter of 2013.

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Now moving to our debt position, our net debt position, we also saw a reduction in leverage of the company by 0.3 times. So again, the quarter we had a net debt-to-EBITDA ratio on a pro forma basis of 2.4 times, compared to 2.7 in the end of the month of December, represented by a net debt of BRL9.6 billion in pro forma basis compared to 10.3 in December which basically means a reduction of BRL700 million.

We saw a reduction in debt; we saw an increase in the cash position. Therefore, again also is a function of the impact of the actual grades variance in these periods, which was enough to recover the debt, but it was not the only factor that plays in the reduction of the leverage of the company.

In terms of the guidance we provided to the market, we basically maintained the previous guidance, as we mentioned in last conference call. We will eventually revise the guidance as a result of the budget exercise for Raizen, but after we finished the budget exercise, basically we have to keep those characters that we have previously disclosed to the market.

There is no question about what could potentially happen or what practice would eventually impact the production of sugar and ethanol at the peak of the crop season. So, there might be a negative impact as the chance that we are going to see more rains than we would normally see during the time of the year or we are going wait a little longer to see how it will play out before we have to decide the production in the sugar and ethanol business.

We have also included a slide with the subsequent events, subsequent to the release of the earnings in the first -- I'm sorry in the fiscal year of 2013. We had Raizen Combustiveis announcement of the acquisition of Latina, which is the fuel distribution company in the south of Brazil, which basically reinforces the strategy to strengthening the position of the Shell brand in the south of Brazil. We had also the announcement of the partnership with Sapore, which is a company dedicated to the production of meals and restaurants, corporate restaurants in Brazil.

We have announced the formation of the company called Sabor Raiz, which will be dedicated to the convenience stores business at the rail road or stations in the State of Sao Paulo. We have also, on 24th of February disclosed our proposal to offer a merger between Rumo and ALL, which was submitted to the Board of Directors of ALL and approved by that Board on the 15th of April, subsequently on May 1st, they submitted the transactions pre-approval of the general -- the Shareholder General Meeting, when it was approved by that Shareholders Meeting. And we are now awaiting the approval of CADE, which is the Antitrust commission in Brazil and ANTT, which is the regulator for the rail road transportation company in Brazil as well.

We have added one final slide, just explaining how the corporate structure of the company would look like after the acquisition of Cosan SA or without the information of Cosan Logistica. And we have also mentioned in the previous calls today that there is a chance that in the future once we formally form the new venture as the result of the

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merger of Rumo and ALL, then we will potentially collapse with Cosan Logistica to form our single entity or at least to have one single listed company in the market.

It's a possibility, we are not confirming it's going to happen, but as we don't expect Cosan Logistica to have any asset outside of the joint venture within Rumo and ALL, it would make sense at some point of time to merge the companies to end up with one single listed company in the logistics business.

So with that, I'd like to wrap up my presentation. Marcos, Guilherme and I are here to answer your questions. Thank you.

Questions And Answers

Operator

Thank you. We will now begin the question-and-answer session for investors and analysts. (Operator Instructions). Our first question comes from (inaudible), HSBC.

Q - Unidentified Participant

Good afternoon, everyone and for the ones in New York, good morning. My question is regarding CapEx for Energia specifically. Since we know that some of the smaller players or the more leverage players are not going to crash or have a lot of difficulties with cane crushing, you guys see more room to get more third-party cane other than your own cane? And was that not to invest as much as in renewed this crop relative to last crop? Just wanted to know if there could be some upside or further reduction in CapEx, because of what's happening in the sector? Thank you.

A - Marcos Marinho Lutz {BIO 6779636 <GO>}

Thank you. This is Marcos. At the end, we are really focused in this operation on cost reduction. When we say, not renewing the cane field, because we don't need as much cane. This again means that you end up with cane fields that would produces higher cost, just the acreage, that's where you won't change and you're for the period it will go down. And just with the operation of cutting the cane, loading the cane and transporting the cane to the mill, this operation is almost two times the total cost of industrial activity. So, actually we are having lower performing cane field, it's a bad idea. What we could argue is, it give us the will to reduce our acreage. Therefore, let's say, give back to landowners the land or basically don't renew contracts or things like that, and get a small acreage and actually since this is on long run for suppliers. Again, duration of one year like that won't change that decision. Our long-term plan is in fact to have suppliers in a larger percentage.

This year, we will be able to crush -- we would be able to crush more cane that we are actually planning, because of lack of cane. So even having people not crushing here and people, let's say, who are not investing as much, the fact is, the amount of cane available in the Center South is actually smaller than people were anticipating, because of the dry weather. So the answer at the end is, no. In one side, this is not bringing that opportunity

yet and the other part of the answer is, yes. We are actually substituting on the long run, our own fields to actually suppliers, there are let's say reliable and loyal to us, because of the relationship we create with technology, with the supply chain and with programs and things like that, that actually bring that loyalty level up.

Q - Unidentified Participant

Thank you. And just one more follow-up on the sugar and ethanol. Do you think, any comment on the Rumo in the second half of the year? It's more rained. Do you think specifically, talking to your team on the ground that more rain at least in June and July could reduce on how much of your output for this year, since we know it's probably the one of the strongest or the strongest months in terms of crushing? So if you have the rain there, how much you can expect and what can be done to mitigate that? Thank you.

A - Marcos Marinho Lutz {BIO 6779636 <GO>}

This year with Rumo, there is probability or likelihood of having some rain in the dry season is higher. You're right, we are actually watching this very closely. If this happens, in one side you increase your productivity of the cane fields. So somehow, because it's been dry throughout -- let's say, some rain at this time for the year, you end up having a little more cane. But in the other side, there will be tough crush, again that impact of this is impossible to measure at this point, because we don't know how much rain this year will be, it's in fact there will be some rain. And for how long, through this end if you have a couple of days of rain, strong rain, or even if you have a weak or strong rains in the middle of the year, in fact this is a positive thing, because we use this time to do maintenance in the mills.

And in fact the cane fields grew like some more water in the middle of the year. So at the end, this being positive, what will be negative, will be actually a sequence of weak rain, that are not as that strong, but actually somehow compromise the field operations and I'd say, the cutting and transporting of the cane in the middle of, let's say, the crushing season.

But again, I cannot give you a number. What I can tell you is that cane is a lot more resilient than other crops. So, somehow those impacts are on the range of 5%, 3%, 7% are now in the range of 30%, 20%. So, we gave our guidance here, we stick with it, I mean, we believe this is a range that we can land. So, even with all of those considerations we have been positive.

Q - Unidentified Participant

Thank you so much.

Operator

Excuse me. Our next question comes from Mr. Pavel Molchanov, Raymond James.

Q - Justin Jenkins {BIO 19131724 <GO>}

This is actually, Justin Jenkins on for Pavel, and thanks for taking the questions. I suppose, I have just a couple of more macro related questions. First, can you give us a status update on potential increase within ethanol blending targets in Brazil? And second, somewhat related I guess, can you share any thoughts on the outlook for the further fuel price hikes and all the effects? Thanks.

A - Marcos Marinho Lutz {BIO 6779636 <GO>}

Well, there's a very long discussion around moving the planning target to 27.5% of the gasoline. I mean this made sense, but probably it won't happen this year. What has to be done here is that we have to change the law that they state that the range is between 20 and 25, so basically, it state that the range would be between 20 and 27.5. This probably is not happening in this election year, but this is an effort of the unit that probably will pass for the medium term. Around price changes in the gasoline policy, I mean a lot of this was discussed and actually published by Petrobras and (inaudible), is that Petrobras should be adjusting slowly to the market price.

We believe that it is tough to do in the election year, where inflation is somehow an issue. But we have in our mind that there is a slightly, a fairly large possibility of having one adjustments, small adjustments still this year. We don't know, I mean at the end we'll have to wait and see, this will probably depend a lot on how inflation on the other goods will behave. So, this decision will be linked to that in the election year.

So, we don't expect any large change this year. We do expect though a larger adjustment for the coming year. We do believe the next year probably, I mean, any government will do some adjustments there more major than what we can expect now.

Operator

Thank you. That does conclude the question-and-answer session for investors and analysts. I would like to turn the floor back to Mr. Marcelo Martins. Sir, please go ahead.

A - Marcelo Eduardo Martins {BIO 16440115 <GO>}

I would like to thank your participation. I didn't catch a comment that I made with Marcos that we will be investing in the railroad side, convenience stores, which is obviously not the case. Sapore is the company that will be dedicated to convenience stores in the highway or the road side or toll road side stations, mainly in the State of Sao Paulo. Okay, thanks again for your participation and we will talk to you soon. Thank you.

Operator

That does conclude the Cosan's audio conference for today. Thank you very much for your participation and have a good day, and thank you for using Chorus Call.

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