

## Q2 2017 Earnings Call

### Company Participants

- Paula Kovarsky, Investor Relations Officer

### MANAGEMENT DISCUSSION SECTION

#### Operator

Good morning, ladies and gentlemen. At this time we would like to welcome everyone to Cosan's Second Quarter of 2017 Results Conference Call. Today with us, we have Mr. Mario Silva, CEO; Mrs. Paula Kovarsky, IRO; Mr. João Arthur Souza, CFO; and Mr. Phillipe Casale, Investor Relations Manager of Cosan Ltd.

We would 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. The audio and slide show of this presentation are available to live webcast at [ir.cosan.com.br](http://ir.cosan.com.br). The slides can be also 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 (sic) [1995] (1:20). 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 operating factors could also affect the future results of Cosan and could cause results to differ materially from those expressed in such forward-looking statements.

Now I'll turn the conference over to Mrs. Paula. Mrs. Paula, you may begin the call.

#### **Paula Kovarsky** {BIO 15363001 <GO>}

Good morning, everyone, and welcome to Cosan S/A's second quarter of 2017 results conference call. As usual, I'll start the presentation by talking about each business line and then the consolidated results. This quarter, however, I will go straight to Slide #4 to talk about Raízen Energia as the explanation on this crop's dynamics and impact on ethanol prices will help us understand Raízen Combustíveis results.

Let's go to Slide 4. Second quarter of 2017 set Raízen's 2017/2018 crop year. That's the start of the crop year. We crushed 19.2 million tons of sugar cane, down 14% year on year. It is worth mentioning that the harvest was anticipated to match the 2016/2017 crop year due to the availability of cane left in the fields during the intercrop.

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So while we started the crop back in April 2016, production was already at full steam, which is atypical. This year instead, a higher rainfall volume delayed crushing, especially if we compare to last year's strong basis of comparison. This delay will not compromise our target of reaching the top - the high end of the guidance range in terms of crushing, which is nearly 63 million tons. Even if we have to crush again until Christmas and shorten the crop a bit.

The TCH was 81 tons of cane per hectare in the second quarter of 2017 versus 92 tons of cane per hectare in the second quarter of 2016 when cane was available but not processed as I already mentioned. The average TRS in the quarter stood at 124 kilos per ton, up 2% year on year, supported by investments in cane treatment. Raízen remains focused in maximizing sugar and the mix in the early crop reached 57% of sugar versus 55% in the second quarter of 2016.

Raízen analyzes the profitability of this process on a daily basis. And that being said, current anhydrous ethanol price is more profitable than sugar in every producing state here in Brazil, as well as hydrous ethanol in some states, meaning that there might be opportunities to optimize the production mix.

Before talking about the performance by product, I'd like to get a little bit more into the details of the crop buying dynamics. Historically, sales of own products are more concentrated in the second half of the crop year when prices are usually more attractive. The previous crop, the 2016/2017, was atypical, not only because the anticipated crushing, and this increases the availability of own products for sale. But also because sugar prices were very favorable in early crop as well as ethanol prices that had an atypical appreciation.

Prices dropped in March with the anticipation of the crushing, but quickly reversed the usual downward trend and went up during the crop's first quarter last year. If you recall, our last conference calls we mentioned that the previous crop had lower seasonality between the two half-years of the year.

This year we saw a crushing delay in the beginning of the crop, resulting in lower availability of own products this quarter and an expectation of a more stable price dynamic. In other words we are back to a more normal crop pattern of prioritizing origination and resale of third-party products in the beginning of the crop and selling our own products in the second half of the crop year.

Now sales performance by product. So let's start with sugar. Sugar sales went up 7% this quarter with sales of own products and higher share of resale. Average sugar sales prices in reals, adjusted by hedge accounting effect and currency hedge on sugar exports, which I will explain in more detail later on, increased 13% year on year.

Ethanol sales grew 26% in the second quarter of 2017 with concentration of resale and trading even higher compared to sugar. Ethanol average sales price came in line with the same period of last year and with market prices based on the evolved number but in reverse direction during the quarter.

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On cogeneration, production and sales of energy grew 10% in the quarter, although crushing has decreased in the period, as there were higher resale and trading volumes of energy in the period as well. Average sales price sold was BRL 220 per megawatt hour, 19% higher than in the second quarter of 2016.

Before discussing the EBITDA, I'd like to recall your attention again to evolution of unit cash cost among products in sugar-equivalent. This index grew 4%, reaching BRL 620 per ton in second quarter of 2017, impacted by higher CONSECANA reference price, which increased 5%, and directly affects land lease agreement and the acquisition of third-party sugarcane. When we exclude the higher CONSECANA price, unit cash cost came in line with the second quarter of 2016, thus absorbing inflation, reflecting continued focus on efficiency in agricultural and industrial operations.

Now referring to adjusted EBITDA. Let me start by highlighting an important change we've made as from this quarter. In order to facilitate the understanding and comparison of results, we've incorporated the currency effect of hedging sugar exports on the adjusted EBITDA of Raízen Energia and accordingly in the pro forma consolidated adjusted EBITDA of Cosan. The adjusted EBITDA now removes the effect of foreign exchange contracted to hedge sugar exports against effective foreign exchange on the shipment date. It is important to mention that as of this quarter, which is higher than first of the crop year, all new derivative instruments designated to hedge sugar exports will be recorded in hedge accounting, so that in the future all instruments related to hedging exports will be reflected in EBITDA.

To be very clear here, average foreign exchange rate was BRL 3.88 to the dollar in the second quarter of 2017, while shipment average foreign exchange rate was BRL 3.20. The financial consideration of currency hedge gain was a for (8:38) of approximately BRL 179 million this quarter. We used to highlight this information for you in our earnings release, but now it is effectively included in our adjusted EBITDA. And we did the same for the previous crop year in order to have a correct basis for compares.

And I also want to remind you that the basic assumption on the hedging policy of Raizen is to protect foreign exchange and commodity, looking at prices in Brazilian real.

Despite the adjustment that I've just mentioned, we've excluded as usual the biological asset variation and the debt hedge accounting. Adjusted EBITDA was down 4% to BRL 804 million in the second quarter of 2017. The adjusted EBIT for TRS sold dropped 14% in the quarter, again due to higher resale and trading volume.

Referring to sugar hedge, the graph in the lower center part of the slide. Since our last earnings release, not much was advanced in terms of sugar hedge. We have 2.1 million tons of hedge sugar at an average price of BRL 0.70 per pound for the current crop year, the 2017/2018.

When the market continues pricing of surplus in the current crop, but we still see it as more of a short term pressure on prices. We'll continue evolving in our cash flow hedging policy. And it is always good to remember that we are talking about the hedge and not

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speculation. And much more important, we remain focused on increasing our operational efficiency and reducing cost, managing investors' capital as well as working capital, while seeking to improve the profitability of our business regardless of price.

Raízen Energia's CapEx totaled BRL 421 million in the second quarter of 2017, up 18% year on year chiefly due to higher maintenance expenses, which are impacted by lower - longer off-season in the year-on-year comparison; acceleration of mandatory investments in health, safety, and environment, as well as sustaining projects; and higher mechanization expenses due to anticipated renewal of agricultural equipment.

Before jumping to Raízen Combustíveis, I'd like to comment on the acquisition of two mills from Tonon announced back in June. So we are going to Slide #5. As already announced to market, Raízen offered BRL 823 million to buy two mills from Tonon both under bankruptcy. These mills, strategically located in the state of São Paulo, have annual potential crushing capacity of approximately 5 million tons. On August 8, we received the CADE's approval with no restriction, which is the antitrust body. But all the figures and projections we are presenting today about Raízen Energia do not include any to no investment or results.

The acquisition process will now follow the legal procedures under Tonon's court provided reorganization. Anyhow, I'd like to take this opportunity to reinforce the reasoning behind this acquisition.

So when we reach the 5 million tons of production, we'll be increasing our portfolio's crushing capacity from current 68 million tons to 73 million tons of cane. As you can see in the map, and this is very important, the two mills are strategically located, because they are close to other mills of Raízen, enabling quite significant synergistic logistics and cost savings, for example, by incorporating those mills to the Pentagon Project, which is our centralized operation center. And this can be done relatively quickly.

So we can now talk about Raízen Combustíveis on Slide 6. Let's start with the market. Although some fundamentals of the Brazilian economy have improved slightly, demand for fuels fell 0.5% in the second quarter of 2017 compared with the same period last year. And that quarter was, in fact, a weak basis of comparison. We're using ANP data here.

Diesel sales are still under pressure and dropped 2% in the second quarter of 2016. Otto-cycle sales, gasoline plus ethanol, grew 1% and the number becomes 3% in gasoline equivalent as a result of higher production and new licensing of light vehicles. The aviation segment was again affected by a 2% reduction in the number of departures in the second quarter of 2017 according to ANAC.

Specifically referring to Raízen now. This was another quarter where the growth strategy ensured our performance over the industry average. We continue investing in the expansion and renewal of our distribution network, focused on long-term relationships with our service stations network and improving the infrastructure and logistics in order to efficiently supply our network.

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Let's talk about the volume. The Otto-cycle sales grew 4% and then the number is 5% in gasoline equivalent in the second quarter of 2017 compared to second quarter of 2016. Raízen diesel sales were up 1% following the trend seen over the last quarters. And in the aviation segment, we were again impacted by lower demand for air transportation and reduction in flights supplied. In the quarter, aviation sales dropped by 6%.

Financially speaking, our adjusted EBITDA came to BRL 557 million, down 7% year on year and adjusted EBIT totaled BRL 394 million, down 12% year on year. We have two relevant factors which influenced Raízen Combustíveis performance, the basis of comparison and a fuel price reduction.

As you can see on the graph on the upper right corner, Raízen Combustíveis higher exposure to ethanol in itself makes second quarters to be seasonally weaker compared to other quarters of the year. Last year however, ethanol price curve was atypical as I mentioned on the Raízen Energia slide. In 2017 not only the price curves return to usual downward trend in the second quarter, but the drop was worsened by gasoline price reduction, which since last October are correlated to international price. In addition and according to Petrobrás' new price policy, we also saw a drop in diesel price. The price reductions in those three products led to a higher inventory loss this quarter, which explains such variation. This effect was partially offset by the growth of volume sold and continued gains deriving from our supply and trading strategy.

Looking ahead to the third quarter of 2017. The expectation so far is of a slight increase in EBITDA, low single digit, compared to the same quarter last year. But it is important to stress that since July, we have been seeing adjustments to diesel and gasoline prices almost every day, which means higher volatility. And as a reminder this expectation is within the guidance range provided for the year.

Raízen Combustíveis' CapEx totaled BRL 202 million, including investments in infrastructure, expansion of service stations network, and conversion of new stations, as well as renewal of current lease (15:51). Raízen ended the quarter with 6,068 Shell-branded service stations, a net addition of 236 stations over the last 12 months and 25 in the quarter. The pace on conversion was lower this quarter as it was in the first half of the year. But there is no change to our full-year guidance in terms of CapEx or the number of service stations that we expect to convert.

Turning now to Comgás on Slide 7. Since Comgás already reported results last Tuesday, we'll go straight into the second quarter highlights. Comgás recorded sales volume growth across all segments, totaling 5% ex thermal power generation. In the industrial segment higher demand in industry-specific segments, such as ceramics, chemicals, and automotive, and the gradual economy upturn sustained a 4% growth of volume sold in the second quarter of 2017 compared to the same period last year, which is still a weak basis of comparison. The commercial volume grew 9% and reflects the addition of new clients over the last 12 months, in line with the strategy of expansion and new uses of gas in the segment.

The residential segment was 17% higher, sustained by customer base expansion. We're talking about 106,000 new clients added in 12 months. And higher unit consumption due the lower average temperature in the period compared to the second quarter of 2016.

Comgás' normalized EBITDA grew 38% to BRL 460 million in the second quarter of 2017, reflecting higher sales volume and correction of margin by inflation as authorized by the regulator in May 2016 and 2017. It is important to highlight here that these adjustments includes a decrease or an increase in the cost of gas, it's a pass through, and incorporation of annual inflation to unit margin as provided for by the concession partners.

Following the trend of reducing the regulatory current account in favor of clients through the movement of gas cost, which was BRL 86 million in the quarter, IFRS EBITDA dropped 43% to BRL - to some BRL 366 million. At the end of the second quarter 2017, the balance of regulatory current accounts was of BRL 268 million, slightly above the estimates due to the foreign exchange behavior in the period. And from now on, the pace of reduction will very much depend on the foreign exchange rate and actual cost of gas molecule, as well as to other parameters agreed with the regulator for the amortization.

Comgás CapEx remains focused on initiatives connected with the expansion of the distribution network and increasing the customer base, which totaled BRL 107 million in the second quarter of 2017, down 2% year on year.

Moving to slide number 8. We'll talk about Moove, our lubricants business. For the second quarter of 2017, Moove recorded sales volume growth across all the markets in which it is present. Such performance is a result of the company's business strategies, focused on increasing both customer base and share in Brazil's automakers market besides the launch of new product.

In terms of volumes the highlight was sale of finished lubes in Brazil and in other South American countries, Bolivia, Uruguay, and Paraguay, boosting the 6% growth in total volumes sold. Higher share in the automakers market in Brazil, higher volume of international operations, and better sales mix contribute to the relevant increase in EBITDA which totaled BRL 53 million this quarter.

Let's now turn to Cosan Corporate. General and administrative expenses reached BRL 35 million, down 15% year on year, reflecting lower graduate services and personal expenses as well as the effect arising from the conditions. Other operating expenses, composed of legal and consulting expenses, totaled BRL 36 million in the quarter due to a high concentration of consultancy expense.

Moving on to slide 9. We present the consolidated results of Cosan S/A on a pro forma basis, i.e., considering 50% of Raízen results. Adjusted EBITDA grew 11% to BRL 1.1 billion, due to the operating performance of Comgás and Moove was partly offset by lower EBITDA from Raízen Combustíveis, impacted by the negative inventory effect previously mentioned, and by Raízen Energia, affected by lower concentration of own product sales in the quarter. IFRS EBITDA, excluding any adjustments, totaled BRL 804 million.

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Cosan reported a net loss of BRL 76 million versus a net income of BRL 280 million in the second quarter of 2016, mainly affected by the biological asset variation at Raízen Energia related to the lower projection of the CONSECANA reference price, and to Comgás' IFRS results, which included the reduction of regulatory current account. When I adjusted by these nonrecurring effects, net income would have reached BRL 24 million in the second quarter of 2017, compared to BRL 163 million in the second quarter of 2016, now on a comparable basis.

Pro forma CapEx came to BRL 427 million (sic) [BRL 425 million] (21:15), up 3% year on year, affected by higher expenses at Raízen Energia and partially offset by a reduction in Raízen Combustíveis.

Finally, free cash flow to equity totaled BRL 613 million, and I'll dig into that number in the next slide. So moving to Slide 10, Cosan's pro forma consolidated gross debt went up 3% year on year in the second quarter of 2017, mainly due to the reissue of BRL 970 million in CRA in a Raizen Energia certificate (21:44 - 21:51). Pro forma net debt recorded similar trends totaling BRL 9.6 billion also impacted by the payment of Cosan's paid dividend.

The company's leverage came in line at 2.1 times pro forma net debt to EBITDA, considering both the figure reported and normalized by the current account effect of Comgás. It is worth mentioning that the seasonality in the pro forma leverage since the working capital cycle of Raizen Energia fluctuates during the crop year.

Pro forma indebtedness average cost including Raizen rose to 102% of the CDI, 108% excluding Raizen. We note that the CDI dropped from approximately 12% in the first quarter of 2017 to 10% in the second, making the cost of debt as a percentage of the CDI to increase, due to pre-fixed debt, which now are compared to a lower CDI.

Now talking about the cash flow through to equity. The main impact in the quarter was the operating cash flow, which increased 17% and came to BRL 1 billion, highlights are Raizen (23:00), partially offset by BRL 86 million reduction in Comgás' current account.

Cash flow from investing activities, main variation between periods is due to the impact of BRL 186 million payment for Rumo's shares previously owned by Gávea in the second quarter of 2016. This will be exercised of a put option owned by the firm, since their investment in the logistics business back in 2009.

And cash flow from financing activity because the second quarter of 2016 was impacted by a negative net effect of BRL 300 million referring to Cosan's debt restructuring process, which included the issue of the 2027 bonds and the buyback of the 2018 and 2023 bonds. Since the process was only concluded in July 2016 with an additional funding of \$150 million. And therefore after the closing of the second quarter of 2016, including our hedge effect. This combined effect resulted in higher free cash flow to the equity generation, totaling BRL 613 million in the second quarter of 2017.

Let's move to the next slide where we restate our guidance. So once again we show our guidance for the full year. There has been no change whatsoever to the numbers

presented last quarter. As usual a few comments on the business performance trend.

At Raízen Combustíveis, we remain confident to end the year within the guidance range and variation will depend on price volatility of the second half of the year. At Raízen Energia, which we'll recover the pace of harvest over the coming quarters. And the crop year crushing is pointing towards the top range of the guidance.

With the downward trend scenario for sugar prices in the foreign markets and the ethanol prices still under pressure, adjusted EBITDA point towards the bottom of the guidance range, already considering the effects of sugar currency hedge build up into it.

As for Comgás, results of today point more to the top end of the guidance range for normalized EBITDA and same for Moove.

So with that I thank you all and open the floor for the Q&A session.

## Q&A

### Operator

Thank you. We will now begin the question-and-answer session for investors and analysts. This concludes today's question-and-answer session. I would like to invite Mrs. Paula Kovarsky to proceed with her closing statement. Please go ahead.

### A - Paula Kovarsky {BIO 15363001 <GO>}

Well, thank you, all, and see you next quarter.

### Operator

That does conclude the Cosan's quarterly conference for today. Thank you very much for your participation, and have a good day.

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