

Q2 2014 Earnings Call

Company Participants

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

Other Participants

- Christian Audi, Analyst
- Paula Kovarsky, Analyst
- Ravi Jain, Analyst
- Unidentified Participant

Presentation

Operator

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

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. (Operator Instructions) The audio and slideshow of this presentation are available through 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 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 Mr. Martins. You may begin your conference.

Marcelo Eduardo Martins {BIO 16440115 <GO>}

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Good morning, everyone. I would like to start our earnings call today with the consolidated pro forma figures for Cosan SA. We saw a jump of 9% in net revenues in this quarter in relation to the second quarter of 2013, with revenues of R\$9.6 billion in this quarter.

In terms of EBITDA, we saw an increase of 6% in the EBITDA in comparison with the second quarter of 2013, with a margin of 9.2% compared to 9.4% last year. Net income, we have a net income of R\$104 million in this quarter in comparison for the net loss of R\$202 million in the second quarter of last year.

I think it's worth mentioning that in the equivalent quarter of 2013, we had a big impact deriving from the FX variance, which basically was the main issue for the net loss in that quarter. We didn't have that same effect this year, and in addition to that we had an increase in the equity result of Raizen of R\$197 million during this quarter.

Now moving to the business -- to different businesses. I'd like to start with Raizen fuels, where we had a jump in the volumes sold of 9% basically in every single business line. So, we're coming from 5.6 billion liters of fuels sold last year to 6.1 billion liters in this quarter. In terms of net revenues, we saw an improvement of 16% resulting in R\$13.7 billion in comparison with the 11.8 in the equivalent quarter of 2013.

The EBITDA margin saw a reduction of 0.4% from 3.5% to 3.1%, but we had a jump of 3% in EBITDA compared to R\$417 million in the last quarter. I'm sorry in the quarter, an equivalent quarter of last year R\$428 28 million in this quarter.

We decided to breakdown the difference in the EBITDA for the first quarter of 2014 and the second quarter of 2014. I would like to explain what the biggest impacts were and where they come from. I will also briefly talk about what happened with the same quarter last year. This is a quarter when we had a lot of non-recurring impacts all across the board in the company and all across the businesses. But in the case of the fuels business, as a function of an advertising campaign we have on open TV here in Brazil, we had invested R\$20 million during the World Cup and this R\$20 million is reflected in the EBITDA of the company of Raizen Combustiveis in this quarter.

In addition to that, the biggest impact basically comes from a negative variance in the ethanol price we sold in the market or to the market in comparison with the acquisition cost of that capital. That we normally, basically buy from Raizen Energia. We have -- that impact was negative in this quarter as a consequence of the price reduction we saw in the ethanol price in the market. So, when we compare the same number with the quarter of last year, we had a difference of over R\$13 million, which basically means that we had a negative variance in the second quarter of 2013 in comparison with the first quarter of 2013 and we had an even more negative variance during this quarter. So, when we look at the second quarter of the fiscal year of the company in comparison with the first quarter, we normally see a reduction as a function of this big variance in the inventory or that could have basically it's not actually there were marking to market the inventory. But it is basically the difference between the acquisition cost and the sale price of ethanol in the market.

So, that was basically the main impact we saw in this quarter and for this reason, we don't foresee any additional substantial impact in the following quarters, as we think that this impact could be even recovered in the third or the fourth quarter of this fiscal year.

Overall, we are seeing the fundamentals of the business continue to be extremely strong, as we have been seeing it in the last quarters and we forecast -- we decided to keep the same guidance for the EBITDA as we forecast recovery in the margin and in the overall EBITDA for this business for the rest of the fiscal year 2014.

Talking a little bit now about Raizen Energia -- I'm sorry just one last point, the 7 million that we see here in the chart, is basically a reduction in fee in real estate sales in this quarter in comparison with the first quarter. So, we saw a 7 million reduction in terms of real estate property sales and therefore the 7 billion impact. And that 7 million is basically net of other gains or positive variations we had in the second quarter for the fuels business in Raizen.

In terms of Raizen Energia, we had a 13% jump or increase in the sugarcane crushed coming from 18.5 to 21 million tons in this quarter. And a 14% increase in sugar production that reached 1.35 million tons in this second quarter. Ethanol production also jumped 19%, which is 705 million liters and energy sold also jumped roughly 19%, getting 684,000 megawatt hour at an average price of 256, which is substantially higher than the 170 average price we sold energy at in the second quarter of 2013. TSR also improved 3% as a function of the drier weather we are having in the Central South Region of Brazil, where the bulk of sugarcane production basically is concentrated.

In terms of the net revenues, we saw an improvement of 14% reaching R\$1.7 billion roughly and a 16% jump in EBITDA from R\$413 to R\$478 million in this quarter with an improvement in EBITDA margin from 27.9% to 28.4%.

The hedging operations were down and basically the balance we had at the end of the second quarter was of 2.37 million tons of sugar hedged at an average price of R\$18.23 per pound at an average real to US dollar exchange rate of 2.38.

Now moving to Comgas, it was a weaker quarter for Comgas in terms of volumes sold, especially as a function of the reduction in economic activity in Brazil. We saw basically an overall reduction of 2% in the volumes sold from 1.43 to 1.4 million cubic meters in this quarter.

Net revenues improved 1% from 1.6 to 1.616 and the EBITDA jumped 34% from 314 million to 420 million. One of the biggest impacts from the improvement of the EBITDA comes from a recovery of R\$73 million of the regulatory account, which balance is now standing at R\$223 million as of the last day of the second quarter of 2014.

In terms of Rumo, we had a 13% increase in the volume loaded, reaching 2.2 million tons, with net revenues of R\$191 million representing an 11% reduction in comparison with second quarter of 2013 and an EBITDA reduction of 36% reaching R\$54 million in this quarter. We had lower volumes transported in the quarter, we could not also implement

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price increases as a function of the increase in the cost of products sold as a function of the FX variation over the last couple of quarters, which had obviously a negative impact on the acquisition costs for base oil, which is have a very relevant component of our cost equation at Cosan Lubricants.

In terms of Radar, we had an improvement of 77% in the net revenues, that reached R\$34 million and it jumped -- substantial jump in EBITDA to R\$85 million in this quarter. The biggest impact basically came from the appreciation of the land portfolio as we market-to-market every quarter and we also had an increase in net revenues as a function of the higher sales of properties in this quarter.

So, I think a made a mistake here. I just realized that when I was talking about lubricants. I just recap a little bit to talk about Rumo that I was supposed to explain a little better than I actually did. We had at Rumo an increase of 13% in the volume loaded, with a reduction of 11% in the EBITDA, which was basically a consequence of a reduction in the volume transported in the railroad system. And that also had a negative impact of 36% in the EBITDA of the company, where the reduction in the EBITDA margin as well.

We had lower volumes transported as we decided basically to nominate a lower volume to be transported by ALL at this point in time.

Now going back to -- of course on lubricants, I think I have already explained what happened with the business, even though we had an increase in the volumes sold and an increase in the net revenues. We had a reduction in EBITDA as a function of an increase in the cost of our main raw material, which is base oil. And also extraordinary expenses due to the World Cup and marketing expenses related to that event.

Now back to Radar, as I mentioned before, we saw an improvement in net revenues and EBITDA as well. So, talking a little bit about the net debt position of the company, we have concluded during the second quarter the structuring of the preferred shares issuance at Cosan. What we did was basically consider it as part of our consolidated debt or our pro forma debt, which includes 50% of the debt of Raizen, where we reached net debt to EBITDA ratio of 2.6 times. When we exclude the impact of the debt coming from, if we book it as that of the preferred equity, we would have ended the quarter with a net debt to EBITDA ratio of 2.1 times.

In terms of the guidance, we decided to revise the guidance and reduce the projected volume of sugar crushed for this fiscal -- for this crop year from 61 to 63 million tons to 58 to 60 million tons. We have also reduced the volume of sugar sold from 4.4 to 4.7 million to 4.2 to 4.5 million and also the volume of ethanol sold from 2.3 to 2.6 billion liters to 2 to 2.2 billion liters.

Energy sold, we are expecting to sell pretty much the same volume that we basically had predicted and guided the market. Therefore, we decided to update the guidance. We have not updated the EBITDA nor revised it because we think that through the reduction in the cost and operational costs of the company should more than compensate the lower sugar cane crushed during this crop year.

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We will provide an updated guidance to the market in the next quarter, as we thought that, maybe we should implement the spinoff of Cosan Logistics or the logistics business and once we do it, we will come up with the new guidance for the market, considering the two separate businesses.

So, you should actually expect a new guidance in the next quarter that as we explained previously shouldn't impact negatively the EBITDA of Ruma for instance and probably Cosan Lubricants under Cosan SA's business as well.

In terms of the subsequent events since our last earnings call or the previous quarter, we had on the 18th of June, the application for the approval of the corporate restructuring at ANTT. On the 21st of July, we had basically the finding for the approval of the corporate restructuring with ANTAQ. And on the 21st of July as well we formalized the merger protocol with the Antitrust Commission in Brazil. And on the 25th of July, we published the Concentration Act with the Antitrust Commission as well.

This is all related to basically the Rumo ALL transaction or the merger of the two companies. Since then we have also approved the share buyback program for Cosan SA, which was disclosed on the 8th of June. And on the 21st of July, we formalized the 2014 -- October 1st, 2014, effective date for the spinoff of the Cosan SA and the creation of Cosan Logistics. I'm sorry the date here is not right. It was not on the 21st of July, it was actually today, the 14th of August.

Okay. I would like to wrap up the presentation just saying that, we recognize it has been a weaker than expected quarter for some of our businesses. I think that, we had a big impact from non-recurring events, which were mainly the World Cup, which took place in the second quarter and also the formation or the basically the merger of ALL Rumo, the submission of all the approvals for the merger of Rumo ALL.

We would like to reiterate the fact that the fundamentals for all businesses continue to be extremely strong and we are very confident that we will see a recovery for the margins of most of this businesses, maybe with the exception of the Cosan Lubricants business, which as a function of a lower or reduced economic activity should be impacted. Even though I think it's also fair to say that we're seeing a recovery in the EBITDA margin for this business in the third quarter, which basically indicates that we're basically having a better quarter than we had the second quarter.

In terms of Comgas, we're also seeing a reduction in the volume sold, which is also a consequence of the reduced economic activity in Brazil. But Comgas is a very resilient business and they have managed to compensate a weaker market demand with sustainable results.

But and again we're not going to be revising the guidance for Comgas. But it's fair to say that we should expect some volume impact moving forward, as we're not seeing a recovery in economic activity in Brazil at this point in time.

With that, I would like to turn it back to you and Marcos 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 Paula Kovarsky with Itau BBA.

Q - Paula Kovarsky {BIO 15363001 <GO>}

I have two follow-up questions from the previous call. The first one is can you possibly share with us the impact of trading activities for Raizen Energia in this quarter? And the other question is, understand that you guys do not intend to provide any guidance revision for Raizen Energia in terms of CapEx for now, but is there room for further reductions in the CapEx for that business unit this year and going forward?

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

Paula, in terms of the trading impact in Raizen Energia was R\$20 million roughly during this quarter. And then in terms of the CapEx, we are obviously trying to reduce even further the CapEx for the company. This is, as we mentioned to the market a few times, this is one of our biggest objectives moving forward, we do what is possible. We don't have anything to anticipate right now. So, it will continue to be the focus of the management of the company.

In addition to that, I think it's fair to say that we're seeing a big improvement in terms of cost reduction, which was one of the main factors responsible for compensating the reduction in the sugarcane crushed with the consequence of a lower sugar and ethanol production as well.

Q - Paula Kovarsky {BIO 15363001 <GO>}

Okay. Thank you.

Operator

Our next question comes from Christian Audi with Santander.

Q - Christian Audi {BIO 1825501 <GO>}

Thanks Mark, Marcelo. Good evening. I had two questions. The first one, Marcelo, touch on the last point you made during the presentation. I just wanted to make sure I understood it correctly. As you look at fuel distribution, you expect, for example, EBITDA per cubic meter to regain a higher level than what we saw this second quarter.

And are you already seeing that type of improvement through the month of July? And then the second question was a broader one. Marcos, maybe if you could just do a

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general overview. When you look at your main businesses and we are faced with the second half of the year, where economic activity will remain challenging. Where do you have higher conviction among your businesses that the fundamentals will really remain in place despite these weaker economic variables? And where do you think, when you have to be realistic, consider there are risks that fundamentals may be more negatively impacted as the economy slows down? Thanks.

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

Christian. First, we have not seen the gross margins of the fuels business shrink this last quarter. So, the EBITDA margin actually had a negative impact provided by those one-time events we mentioned.

So, yes, we not only, but we already see and we already saw the maintenance of our margins and we expect a lot better EBITDA margin than last quarter -- in this quarter we are through now. So, this is quite straight forward.

And actually starting to answer your second question, we see this business as a very resilient one, despite having let's say both aviation and B2B diesel exposed to GDP. The bulk of the business, I would say will be, let's say resilient and will actually be on the same levels and with some growth pretty much in any scenario we foresee today.

So, this is a very resilient business.

Comgas, again is very resilient too. We might see a lower volume on the industrial side that's correct. We don't see though a big impact on the negative side happening on the full-year for Comgas.

On Cosan lubes is where I see again a better second half than the first half, but this would not compensate, let's say, the whole this second quarter, putting our budget for the year. So, Cosan lubes if I would put that in and let's say internal way is probably the one business in the Cosan portfolio that won't meet the budget on the EBITDA side.

We might have good surprises on the end of the year. The second half is normally the strongest half of the year. But again, we actually missed a big number on this last half, will be tough to, let's say, compensate for that on the second half.

But the second half, I would say will be a good half of the year. We will see, let's say, good numbers for this business as well, as let's say, the World Cup effect would not be present.

Again and then Rumo ALL, again this is a pending merger, subject to approval on the CADE. So, it is tough to give clear guidances for you, given that we don't know exactly the timing of this approval and exactly when we will deploy and start doing what we believe should be done. So, it's tough to give you that guidance.

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But this business as a whole, it is quite strong, because both actually are driven by demand and the demand is there. I mean there is product to haul. This is very resilient on the long run. This is something that Brazil will need now and for good.

So, this infrastructure will be actually serving in any scenario those main markets and again is more a homework of cost reduction and volume capacity improvement and anything else. Therefore is not to be very impacted by the economic scenarios.

Q - Christian Audi {BIO 1825501 <GO>}

And what's the base case you're using for this approval timing, Marcos, for Rumo? Is it a third quarter event, fourth quarter event for us to be able to provide more guidance?

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

With the lack of our best estimates, we have as a base case at the end of the year, okay. But again, this is educated guess, but again not that well educated, because it's tough to predict what will happen. We're starting the process and this will be, let's say, a process throughout election times. I mean -- this time is actually the timing for this, we don't anticipate problems, but for us the big question mark is a wrong timing.

Q - Christian Audi {BIO 1825501 <GO>}

Okay. Thank you.

Operator

Our next question comes for Ravi Jain, HSBC.

Q - Ravi Jain {BIO 16135293 <GO>}

Hi, good morning. I had two quick questions. On the Rumo front, should we continue to expect the lower transported volumes for the balance of the year? And looking more into 2015 as to, should this be normalized once the duplication between Campinas and the Port of Santos is completed?

And my second question is on Comgas. When do you expect to finalize a new rack with the regulator? And do you expect the commercial and residential segments to pick up growth in the next 6 to 12 months, given that they have really strong potential? Thank you.

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

Ravi, first a slight correction on Marcelo's point around volume. In fact we had transported all the volume that we were planned. What happened was really on the revenue side, where we unilaterally decided not to charge fees and things for now, given that there is, let's say armistice on the judicial issue against ALL. So, at the end that was the main thing and I would say you should expect this for the remaining of the year.

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On the timing side as I mentioned, I mean, let's say, on the law CADE has 11 months to approve a deal okay. So, the worst-case scenario for us will be 11 months. We don't see this happening from our brief discussion, initial discussions with them. We understand, they are very focused in judging this quickly. I think quickly should mean three, four months.

So, the timing would be -- but again, it's tough for me to -- I mean you should not assume this in your decision because again it's just a guess given that the law will say that we have up to 11 months. We have many cases, where CADE made this type of call in a month. But again, given the size of this and the impact in the Brazilian economy this might take a little longer.

So, that's -- and what was your -- about CapEx. I see probably in the next six months that duplication part actually Rumo is paying for and from the beginning in the contract. This probably will be concluded. So, Campinas all the way to Santos will be duplicated pretty much in six months from now, which will debottleneck a big chunk of capacity there. Was that your question?

Q - Ravi Jain {BIO 16135293 <GO>}

Yes, and once that is duplicated, do you expect that the margins and the pricing of the transportation business will get back a little more normalized? Or do you still expect to see these challenges?

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

No, again, I think this will probably get normalized. The thing is there is a very large effort on actually making those, let's say, those systems, rail systems all over the place to have the capacity and let's say and the reliability needed for the market.

So, if you ask me, let's say, short-term timing will be tough for us to answer, because we are still not with the information in detail that we will have after the CADE approval, after the CADE approval is when we actually can really start pulling together, let's say, the management and, let's say, how you say that the programing and let's say the management structure that we believe is right. Will be done after that.

So, at this point, we have very limited access or -- and no influence in the company's daily operation. So, timing-wise in four months, if CADE approved us, then we will start to answer questions as schedule or how many months will it take to get to this level of capacity, to this level of profitability and probably six months from that approval is when we will be able to come back to you and say you know, what, this is the plan, this is, let's say, the expected returns on the plan and this is exactly what we'll do and this is the timing that those things will happen. So, at this point, we know the direction, a very clear direction and the potential of all of the things, but it's tough to define the timing at this point.

Q - Ravi Jain {BIO 16135293 <GO>}

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And on the Comgas just quickly as to when do you expect to finalize the new rack [ph] with the regulator?

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

Beginning of next year.

Q - Ravi Jain {BIO 16135293 <GO>}

Okay. Thank you. That's helpful.

Operator

Our next question comes from Mark Smith with (inaudible) Capital.

Q - Unidentified Participant

Thank you. Just going back to the issue of the nature of your business, as you say, there are a number of parts of your business which are fairly predictable and steady businesses. Yet overall as a company, I find it very frustrating quarter-by-quarter the surprises that happen each quarter, the one-offs. The sort of known-unknowns. Do you think there's a time out there when the overall performance of the group becomes rather more steady and predictable? Or is it just the nature of the businesses that you're in that we have to live with these events quarter-by-quarter?

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

Mike, we understand your point and honestly, if you look at this company, since 2008 this was basically when we started this transformation and movement to diversify our portfolio away from sugar and ethanol.

And since then we've been making substantial acquisitions non-stop.

I mean if you look at Comgas few years ago, and then last year we had the consolidation of Comgas and then we have the formation of Ruma and then we announced the merger with ALL. And previously we had Raizen and then before Raizen we had the acquisition of ExxonMobil's asset.

So first, I think that the last six years have been extremely active for us and it's very hard to predict a business that keeps evolving like that. I think that we have reached a point right now and I think that the spinoff of the logistics business is going to help us tremendously because we're basically separating a business that is much more volatile, and we're going through a transformational process as well, from a business that is more stable and it has more predictable cash generation.

Sugar and ethanol is a commodity. I mean it's a business that will keep, whether its volatility because of the nature of the products we sold. If you look at Cosan, I'm sorry at Raizen Combustiveis, I mean we may have had in the past some volatility within the

quarters. But the result of the year was pretty much in line with what we indicated to the market, maybe it's harder for us to predict what's going to happen within the quarters.

And again even within the quarters, when you look at what happened with the fuels business, you will see that there is a pattern. I mean, the first quarter is better than the second, the third is better than the second and then the fourth is the best quarter of the year.

This is normally the way it works, I mean, historically. I know it can be frustrating sometimes, what we're trying to do is, we're trying to disclose as much information as possible, so that you understand what are the factors that impact the business.

I think that with the creation of Cosan Logistics, it will be much easier to explain the difference -- that the differences in the businesses because they are completely different businesses impacted by completely different factors.

And hopefully it will improve the way the market will read the businesses and it's going to have an immediate reflection in the stock price. That's what we expect. But I mean, I understand what you're saying and we're trying to do all we can to minimize this impact.

Q - Unidentified Participant

And the thinking behind the spinning off of the Logistics business. I mean it seems only a short while ago you were seeking to do deals in this area and build it up as a core business. So, what has changed there?

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

Well, Rumo is a company we started from scratch, right, as you know in 2009, 2010. Since 2012, we've been trying to acquire a relevant stake in ALL. We didn't succeed after some ups and downs in our negotiations up until six months ago, when we basically managed to at least reach an agreement with some of the shareholders of the company. And now we're waiting for the approval of the Antitrust. I mean a lot happened since then and then we started Rumo as I said with two terminals in an investment of R\$100 million. And today we have a business that is worth R\$4 billion and now we're trying to improve this business even further through this merger with ALL.

And again this is probably the biggest transformation in our portfolio, but we haven't concluded that step yet, which something we expect to happen until the end of this year.

Q - Unidentified Participant

But is it a recognition that the nature of this business is very capital intensive and very -- it takes a long, long time. Is that part of the issue here?

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

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Yes, it is. It's a capital-intensive business because as you know through the integration with Rumo and our willingness to expand the capacity in the railroad, we're going to have invest a substantial amount of money.

We're doing that based on the assumption that the money is going to come in good part from BNDES and we'll also be able to get an extension in the concession agreement from the regulators. But it is certainly in nature a very different business from the energy business, because I mean, the cash flow generation in this business probably take some time because of the investments we need to make. While in the energy business, we have existing cash flow generation, which will keep improving over time.

Q - Unidentified Participant

Okay. Thanks.

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

Sure.

Operator

Thank you. That concludes the question-and-answer session for investors and analysts. I would like to turn the floor over to Mr. Marcelo Martins to proceed with his closing statements.

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

Well, I'd like to thank you again for participating in our call. We're going to keep you updated with farther moves and especially related to the Rumo ALL transaction and we hope to talk to you very soon. Thank you.

Operator

That does conclude Cosan's audio conference for today. Thank you very much for your participation.

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