

Y 2018 Earnings Call

Company Participants

- Phillipe Casale, IR Executive Manager

Presentation

Operator

Good afternoon, ladies and gentlemen. At this time, we would like to welcome everyone to Cosan SA's Fourth Quarter and Year of 2018 Results Conference Call.

Today with us, we have Mr. Phillipe Casale, Investor Relations Executive Manager and Mr. Joao Arthur Souza, Head of Finance.

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 slide show of this presentation are available through live webcast at ir.cosan.com.br. The slides can also be downloaded from the webcast platform.

Before proceeding, let me mention that 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 are related 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. Phillipe Casale. Mr. Casale, you may begin the call.

Phillipe Casale {BIO 20025617 <GO>}

Good afternoon, everyone, and welcome to Cosan SA's fourth quarter and 2018 earnings conference call.

This conference call will be a bit different. As we have already announced to the market, there are a few operations underway in the capital markets involving the Group. Cosan announced the voluntary tender offer for the acquisition of Comgas preferred shares and Raizen is in the process of issuing agribusiness receivables certificates. For this reason, we

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are suspending the disclosure of guidance for now. Presentation and the Q&A session will be strictly about fourth quarter and 2018 results and we will not be able to talk about expectations on future results. Once these operations are concluded, we will resume guidance disclosure.

Now let's move to Slide 4 to discuss results starting with Raizen downstream operation recently acquired in Argentina. This is the first quarter that we released our results of refining and distribution operations in Argentina. This acquisition was concluded on October 1, 2018, which means we will be talking about the full quarter. Before we start, I would like to give two disclaimers. First, downstream operations functional currency in Argentina is the US dollar. So we will report the results in this currency. Second, we will not disclose comparative periods prior to the execution, since Shell's operation in the upstream and downstream were consolidated and we don't have this required separation for comparison purposes.

Let's now discuss the figures. 2018 was quite difficult year for Argentina. Severe economic distress resulted in the depreciation of Argentinean peso, inflation and high interest rates. In the fourth quarter of 2018, economic scenario improved from previous quarters but a sharp drop in oil prices in the period directly impacted Raizen's results. Total volume processed by Raizen refinery was 75.5 barrels a day. The utilization factor in the refinery was 75% this quarter, impacted by a scheduled maintenance in one of its plants. The normalized level for refinery utilization would be around 85%. It's worth mentioning that the operations have already been established after the downtime.

Moving to the volumes sold. Diesel and gasoline dropped 10% compared to 4Q '17 due to the lower economic activity that impacted demand in the period. Volume of aviation fuel grew 22% due to the increase in cost in the space and greater market share. The quarterly EBITDA was \$22 million, adversely affected by oil price drop, as well as the downtime in the refinery's production plants in December, which resulted on and one-time higher origination of fuel volume supplied to service stations. Capital expenditures in the quarter totaled \$36 million, of which nearly 90% relates to refinery operations and maintenance.

Let's now move to the next slide to discuss Raizen Combustiveis operations in Brazil. 2018 was a challenging year for the fuel distribution industry in Brazil as well. Besides the high price volatility, FX rate and oil price fluctuation, the truckers' strike and subsequent effects added up to economic slowdown and weaker demand for fuels. The demand for fuels is gradually recovering since the truckers' strike in May.

Total sales volume grew by 4% in the quarter and 2% in the year, the highlights being diesel and jet fuel. In 2018, diesel sales reflect a greater demand for agribusiness and B2B clients. The jet fuel followed the upturn trend of these segments. In the Otto cycle measured by gasoline equivalent, sales were down by 5% and 2% respectively in 2018 and in the quarter, affected by lower demand in the country. Ethanol parity remain below 70% in a few regions, boosting a higher consumption of the biofuel versus gasoline.

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Now referring to EBITDA, the sharp drop in international oil prices at the end of 2018 impacted the average inventory in the quarter and required additional efforts and an assertive supply and commercialization strategy from Raizen. As a result, adjusted EBITDA in the quarter grew 1% to BRL870 million, but it went down 6% to BRL2.8 billion in 2018 in line with the guidance analysis. I'd just like to remind that we reduced the guidance in November of 2018 since the volatility of the commodity price would bring an additional challenge for us to offset the truckers' strike negative impact to the results.

Now CapEx. We ended 2018 with 6,500 services stations, a net addition of 252 stations and a total investment of BRL857 million in the year, in line with the projections. These investments involve maintenance, conversion of new stations and contractual renewals.

Now let's discuss Raizen Energia results on Slide 6. In the third quarter of 2018-19 crop year, traditionally, at the end of the crushing season in Brazil's Center South region. Raizen crushed 60 million tons in this crop year, down 2% from the previous year. According to UNICA figures, crushing decreased 4% in the Central South Region in Brazil. Drier weather had a negative impact on agriculture yield which reached at 9.1 kilos of TRS per hectare in the accumulated crop at Raizen, and therefore, impacting the volume of cane crushed. Production mix was 53% for ethanol from 45% in the previous crop year, in line with our strategy of focusing on higher profitability products.

Let's now talk about sales volumes of each product starting with sugar. As you can see in the graph on the right side, sales volume dropped 46% from 4Q '17. We concluded a few storage investments in our plants, which gives us greater flexibility to optimize the commercialization strategy with higher profitability.

Sugar inventory volume grew 8% when compared to 3Q '18, in line with the sales trend for this crop. Average sales price in Brazilian reais came 3% lower from 4Q '17, following a sharp drop in international sugar price.

Now ethanol, the sales were 31% higher this quarter driven by higher demand for the product and in line with commercialization strategy for this crop with a higher concentration of volumes in the fourth quarter of 2018. Average sales price came 12% higher than the same period of the previous crop and slightly above the industry average due to the portion of the sales that were hedged at prices better than those seen in the domestic market.

On the electricity side, as mentioned in the previous quarter, cogeneration results are impacted by WX operations, our electricity trading company. Just reminding that we now breakdown own products and sale trading volumes, like we do for sugar and ethanol since this operation brings a significant impact on the revenue but it's margin are substantially lower than the sale of electricity generated by Raizen.

First, own products sold declined 16%, reflecting lower biogas availability related to reduced crushing. Average sales price also decreased, especially in the spot price. Before discussing EBITDA, I would like to highlight the unit cash cost, excluding the cost accounting effect. In the quarter, unit cash cost increased by 14% reflecting the higher

diesel prices, reduced agricultural yield, lower dilution of fixed costs due to the lower crushing, as well as inflation in the period.

Adjusted EBITDA reached BRL835 million, 6% lower than the 4Q '17, mainly reflecting the lower sugar price and drop of sugar sales volume, in addition to the higher cost incurred in the quarter. Once again, it is worth noting that the commercialization strategy defined for this crop will concentrate a higher sales volume in the last quarter of the crop year, which impacts Raizen Energia's results and cash flow.

Regarding sugar hedge, we're fully hedged for sugar exports for the current crop at an average price of BRL0.50 per pound. For the '19-'20 crop year, we reached nearly 50% to 55% of the total sugar to be exported with an average price of BRL0.57 per pound, a 15% improvement from current crop price.

Regarding sugar global scenario, we are surrounded by uncertainties concerning the size of the next crop and depending on the climate and production mix, there are consulting firms talking about (inaudible) in the global sugar balance, calling for better pricing environment. Lastly, Raizen Energia CapEx was 16% to BRL650 million in the fourth quarter of 2018 due to the higher planning, enthused renewal expansion in line with expectations for the crop.

Now let's move to Slide 7, talking about Comgas and Comgas released its results on Tuesday. So we'll go straight to the highlights here. Natural gas volume excluding thermal power at 6% both in the quarter and in 2018, with growth in all segments. Higher sales reflects commercial efforts to increase volume in the current customer base, jointly with network expansion in saturation. This quarter we recorded a non-recurring positive effect on the EBITDA of BRL760 million related to the conclusion of legal disputes, resulting in a year end normalized of EBITDA BRL2.7 billion. Excluding these effects, normalized adjusted EBITDA totaled BRL546 million in the 4Q '18, 12% higher than the same period last year, mainly due to the higher volume sold. In 2018, normalized EBITDA, as mentioned, 12% to BRL1.9 billion, already excluding the same non recurring effect already mentioned.

Comgas accumulated the regulatory current accounting in the quarter we for current balance of BRL251 million in favor of Comgas due to the gas price movement in a period. Lastly, CapEx totaled BRL148 million in the quarter and BRL530 million in the year in line with the CapEx plan of Comgas.

Let's move to Slide 8 and before discussing Moove's result, I would like to remind you that as announced to the market. In December 21st of 2018, Moove will receive a capital contribution of up to BRL562 million from CPC fund, responding to a 30% stake in the Company.

(inaudible) offer strategic partner, we will contribute to expanding the company's lubricant business besides optimizing its capital structure. We also would like to remind you that we recently initiated lubricant distribution operations in France, Portugal, Argentina and United States, besides expanding our business in the UK. This is a model similar to the model of

the other (inaudible) focused on the commercialization and distribution of lubricants and other products to different types of clients with marginal investment.

Now let's discuss Moove results. We improved the performance of finished lubricant sales in Brazil and other countries, boosted EBITDA growth, which reached BRL61 million in the quarter and BRL238 million in 2018, also in line with the guidance announced. The better results reflects better product mix with have more contribution from finished lubricants, as well as synergies captured by the expansions of international operations.

Moving the corporate segment. On the right side of the slide, Cosan's corporate G&A expenses declined to 14% in 2018 as a result of the Company's efforts to cut costs. Other operating revenues and expense gaining positive BRL96 million in the quarter, impacted by a reversal of provisions and by a positive one-off effect deriving from the exclusion of ICMS, which is the state tax from the calculation basis of PIS/COFINS, which is a federal tax from the past periods.

Moving to Slide 9. We present consolidated results of Cosan's sale on a pro forma basis, considering 50% of Raizen's results. Cosan's pro forma adjusted EBITDA grew by 23% in the quarter, but went down 2% in 2018, reaching BRL5 billion, in line with the guidance. Adjusted EBITDA reduction reflects lower results of Raizen Combustiveis, mainly impacted by the truckers' strike in May and Raizen Energia affected by lower production and average prices in the period.

Cosan's adjusted net income totaled BRL730 million in the fourth quarter, also benefited by the non-cash effect of tax variation of the unhedged portion of the perpetual bond. In 2018, adjusted net income totaled BRL1.3 billion, 35% higher than 2017, benefited by an improved net income of Comgas and Moove.

Let's go to the next slide to discuss the main impacts on the cash flow. Starting with operating cash flow, which increased in the quarter compared to 4Q '17, mainly due to the improved working capital dynamics at Raizen Combustiveis, Brazil on the back of supply dynamics in the period and the renegotiation of agreements which extended payment terms. This effect was offset by Raizen Energia's commercialization strategy with higher inventory volumes in the quarter.

In 2018, operating cash generation (inaudible) 9% to BRL5.3 billion. Cash flow from investments was affected by disbursement on the second installment of \$317 million related to the acquisition of Shell's assets in Argentina. It's worth noting that upon the operation's signing in April last year, Raizen paid \$100 million to Shell and (inaudible) installment to be paid by December '19 in the approximately amount of \$450 million. These amounts that I mentioned previously are equivalent to 100%, but we only consolidated 50% of Raizen's results which is equivalent to our stake in the Company. We've recorded our disbursement of BRL61 million referring to investments to start its operations in U.S.

In cash flow from financing activity, there is a mismatch between funding and debt amortization at Comgas and Raizen with a non-recurring effect on cash generation in the

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period. Thus, the Company posted negative free cash flow to equity in the quarter of BRL560 million while in 2018, pro forma free cash flow to equity was almost double the figures from 2017, totaling BRL1.4 billion. Cosan pro forma gross debt, including 50% of Raizen results, came in line with the third quarter with an average cost of 104% of CDI. Lastly, I would like to point out that our leverage normalized by the current account effect of Comgas ended the year at 2.1 times net debt considering the pro forma EBITDA.

Before concluding the presentation, I would like to remind you that due to the transactions in progress that I mentioned in the beginning of the call, the company decided to suspend the disclosure of the guidance and we will also not be able to discuss expectations relating to plans, future events and trends affecting our activities. Once these operations are concluded, we will resume disclosing guidance.

Last but not the least, our Cosan Day of 2019 will take place on March 19 in Sao Paulo and March 22nd in New York. We will disclose more details soon, but I'd like to take this opportunity to invite you all to save the day of our Annual Meeting.

That concludes my presentation and we can now start the Q&A session. Thank you.

Questions And Answers

Operator

(Operator Instructions)

Thank you. As we don't have questions, this concludes Cosan's audio conference for today. Thank you and have a good afternoon.

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