

Q2 2015 Earnings Call

Company Participants

- Marcelo Eduardo Martins, Board Member of Cosan S/A and Chief Financial Officer of Cosan Limited
- Nelson Gomes, Chief Executive Officer & Investor Relations Officer

Other Participants

- Rodrigo Mugaburu, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to Cosan S/A Second Quarter of 2015 Results Conference Call. Today with us we have Mr. Nelson Gomes, CEO and Investors Relations Officer; Mr. Joao Arthur Souza, CFO; and Mr. Phillipe Casale, Investor Relations Manager of Cosan S/A. 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 analyst. At the time further instructions will be given. (Operator Instructions) The audio and the slide show of this presentation are available through a 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 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 the 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 (inaudible) this conference call, I'll turn the conference over to Mr. Marcelo Martins, Board Member of Cosan S/A and CFO of Cosan Limited for his opening remarks. Mr. Marcelo, you may begin the call.

Marcelo Eduardo Martins {BIO 16440115 <GO>}

FINAL

Good morning, everyone. The purpose of my participation or my short participation in the call today is basically to try to address some of the issues that have been raised by the market in relation to Cosan S/A and potential investments in its current businesses and other businesses, as well as the spin-off of the gas distribution business, which was announced last year.

As you know well, Marcos Lutz and I have formally become Executives of -- actually, we were already, but we have -- we're now 100% dedicated to Cosan Limited as Executives, but we continue to be Board Members in the companies that are controlled by CZZ.

We have last year in -- during the Cosan Day meetings announced our intention to spin-off the gas distribution business out of Cosan S/A. I just want to confirm that it continues to be our objective to implement that transaction or the spin-off. The only reason why we have not done it yet is because we have also committed to transfer part of the debt that today sits in Cosan S/A to this new entity for the gas distribution company. And considering recent market conditions, we are not able to do the refinancing as part of Cosan S/A's debt, in order to transfer the new debt to the new entity to the gas distribution business.

But once we are in a position to do it, we will complete the spin-off of the business. We continue to be highly committed to doing that deal, and we also as the consequence of that first move, we continue to be 100% committed to simplify the structure, so that we have only one listed company for each energy logistics and gas distribution businesses.

There is another issue that was raised by the market recently which has to do with the fact that, there were some rumors in the market about potential investments in other businesses, in addition to the businesses we're in today. And I want to clarify that, we continue to be focused on the cash generation, the operating cash generation of the businesses we control today, including Raizen, and the main purpose is to generate cash to reduce the debt that today it's in Cosan S/A.

We don't think that the current leverage is at a level we think is adequate for this business, and even though we are happy with the consistent performance of the businesses, we will only be 100% satisfied once we get to a leverage that we consider to be adequate, which is in our opinion not higher than 2.5 times EBITDA. As you know, we have last year completed the spin-off of the logistics business, so today Rumo, ALL are controlled by Cosan Logística, and this is another business we intend to simplify it over time, as we have also already mentioned to you guys, to the investors in the recent -- in the most recent Cosan Day, in the most recent Investors Day.

Therefore, the reason I'm here today, as I said before is that to confirm that we are very committed to improving the efficiency of the businesses with the cash generation of all the businesses that today are controlled by CZZ and with the reduction of our debt, improving our capital structure over time.

With that I would like to conclude my presentation and turn it over to Nelson Gomes, who will make the presentation now to you, and I hope to talk to you again in the next event.

Thank you very much.

Nelson Gomes {BIO 7487048 <GO>}

Good morning, everyone. Welcome to the Cosan S/A Second Quarter 2015 Earnings Conference Call. As we did in the last quarter, we will discuss our business performance of Raizen Combustiveis, Raizen Energia, Comgas, Lubrificantes and Radar.

Starting on the page four, we have Raizen Combustiveis (Technical Difficulty) our fuels distribution business. Before we go through all the numbers, I'd like to say that, start this quarter, we will report the fuel volumes sold exactly in the same way that's in the account thus, basically excluding all the volumes sold among other distribution companies. The main reason behind this change is to really facilitate comparisons between the results reported by us and by the market.

Now going to the numbers. The volume this quarter on our fuels distribution business were impacted by the drop on the economic activity, mainly on diesel sales. We'd suffer a 2% drop when compared with the same quarter last year, not only on B2B, but also in retail. Despite this challenging macroeconomic scenario, we are presenting 0.4% growth on total volumes sold, mainly driven by the growth of 5% in gasoline and ethanol business that are more resilient during this economic downturn.

The aviation segment went down 3%, impacted mainly by the fire [ph] activity reduction in Cosan. On the EBITDA, we are also reporting in this quarter above and beyond the accounting EBITDA and adjusted EBITDA, which excludes one-offs, as detailed in the right side of the slide. The accounting EBITDA was 514 million, 20% above of the same period - the same quarter of last year. When adjusted by the non-recurring effects related basically to the World Cup last year and some assets, divestments, the adjusted EBITDA on this quarter was 508 million, 16% above the same period of last year, mainly driven by a better sales mix of gasoline and ethanol as I said before.

It is also important to highlight that Raizen's business relationship model with its dealers, it's a little bit different than what the market usually does. So what we do, instead of anticipating the whole CapEx when signing the contract, the model assumed some volume targets to be achieved along the way during the conference. When reaching those targets, the dealers, they get the benefit of a discount, which is accounted by Raizen Combustiveis, as a matter of revenue reduction, known as a rebate or the discount.

In this quarter, the rebate or the discount was BRL35 million, as you can see in the highlighted growing numbers in the graph.

The chart on the right demonstrates the behavior of our unit margins in reais per cubic meter on a quarter-by-quarter basis. And as you can see, the second quarter unit margins, which is the first quarter of the crop season are impacted by higher ethanol sales or probably with lower unit mark. This seasonal effect, the weaker margin in the 2Q was already anticipated, and does not affect our margin estimates for the balance of the year.

Now turning to page five, Raizen Energia. Again before we start, it's worth to mention that in the last quarter, Raizen Energia has been increasing the resale volume, both for sugar and ethanol, and also the trading volume of ethanol. So based on that fact, starting this quarter, we will open the breakdown information between our own volumes produced and sold, and third-party volumes both for resale and trading. Those operations which is basically originating sugar and ethanol from the market and resell it, aims to generate scale on our business and also dilute our fixed costs. However, it's important to highlight that when we look at the margin EBITDA specifically in this resale and trading operations, they are not relevant.

Now talking about the crushing of this quarter, the beginning of the crop season was postponed, as I already mentioned due to weather conditions, and led basically our 23 mills in activity, just remembering that one of our mills, Bom Retiro is temporarily hibernating to crush 19.2 million tons this quarter, 8% less than the same quarter of last year, were different than the last crop season, where we faced a relatively dry intercrop, the range we had in this intercrop season from January to March this year improved the agricultural productivity by 11% from 9.9 to 11 tons of ATR per hectare.

Also its worth to mention that since June, we've been achieving very high daily crushing volumes, which will lead us to recover production -- the total production volume over the coming quarters.

Now, talking about volume and prices of the products, sugar, ethanol and cogeneration, and starting with sugar. The volumes sold in the 2Q were 15% lower than the 2Q of last year, mainly due to the delay on the harvest, which reduced the sales of our own volumes, partially offset by higher resale volumes, as I said before. The average prices were also down 6% due to the hedging account effect of BRL104 million impact on the net revenue. If we adjust the sugar net revenues with this effect, the average sugar prices would be BRL1,045 per ton instead of BRL854 per ton.

The ethanol was also impacted by the delay on the crop season. The sales of our own volumes were 26% lower, but the total volumes were different than the sugar, which includes resale and trading was increased by 10%, mainly due to the higher demand of ethanol in the market. The average price was down 3%, driven by the increased supply of this product, when compared with the same period of last year.

In Cogeneration, there was no material change in the business performance, even considering that we crushed 8% less this quarter. Talking about the EBITDA, starting this quarter we will also report an adjusted EBITDA that was 328 million, which excludes the biological assets variation and the hedging -- the hedge accounting impact. Even with these adjustments, the 2Q EBITDA was highly impacted by the lower own volumes sold than the higher resale and trading volumes, of course with lower margins again as I already mentioned.

CapEx this quarter was 381 million, 33% below the same quarter of last year. Overall, two-thirds of this reduction was planned and expected due to one, the completion of several projects that are being finalized; and two, the increase on the mechanization level that

reached 97% this quarter, both of this impact in line with the guidance. The other one, third, it's really related to the maintenance, and it's driven by the harvest delay, and we'll catch up in the upcoming quarters.

The last graph in the lowest right-hand corner shows our hedge position this quarter, very similar to the 2Q14, both in volume and in reais. Obviously, the values in cents per pound reflect the evaluation on the reais in the period. At the end of the 2Q, we've had a 70% of the total sugar export volume hedged at an average US dollar rate of 299, reminding that our hedging policy includes the currency, so the prices are hedging -- are hedged in reais without any further exposure to US dollars.

Now turning to page six, Comgas. Comgas as you know held the 2Q earnings conference call last Tuesday. And for this reason, I will cover briefly some of the numbers. Starting with volume, the positive highlight on this quarter was the commercial segment which was increased by almost 7%, it's volume sold, and connected more than 1,200 new customers in the last 12 months.

The volumes sold to the residential segment stay stable, although we added 115,000 new customers to the network on the last 12 months. This growth was offset by the reduction on the unit residential consumption due to the water crisis, and the drought in the state of Sao Paulo. The Industrial segment, as you all know remains impacted by the economical slow down and decreased 4% when compared to the 2Q14.

In the graph on the right, you can see -- each segment's relevance on total volumes sold, in their respective contribution margins -- they expect contribution margins. The expansion focus of the results are on both commercial and residential segment, the ones with higher unit margin.

Now talking about EBITDA, the better sales mix on this quarter, as already mentioned associated with lower levels of SG&A and also with the tariff review granted by the regulator last May, drove a growth of 13% on both IFRS EBITDA and adjusted EBITDA, which includes the regulatory account effect. Now talking about regulatory account effect, the recovery on this quarter was BRL81 million.

Now turning to page seven, the Lubricants business showed higher EBITDA due to one, better results from international operations; two, better sales mix; and three, lower raw material costs. It's also important to remind that in last year -- the 2Q last year, the Lubricants business was also impacted by negative effect related to the World Cup.

Radar presented slightly lower sales of our own land in the quarter, but the relevant effect on EBITDA was driven by a lower variation of the fair market value on our own portfolio. Now talking about other business, the main variation on the expenses is related to the last year's impact on the 2Q of BRL115 million, expenses related to the Rumo and ALL merger. It's important to remind, as we did in the last quarter, there are no further expenses are expected from this transaction.

Now turning to page eight, we will now talk about the pro forma Cosan S/A consolidated results, which again is based on 50% of Raizen Energia and Combustiveis, then 100% of the controllers' businesses. This quarter, the net revenue increased 7%, reaching 10.1 billion.

The pro forma EBITDA on the quarter was 874 million, 6% above the 2Q last year. Following the same concept presented before for each one of the business, we are presenting also on an adjusted EBITDA, that was 815 million, 5% below the same quarter last year, which was also adjusted.

CapEx on this quarter was close to 400 million, a 25% reduction when compared to the 2Q14, mainly driven by the reduction in Raizen Energia, and a small reduction in Comgas. This overall CapEx reduction combined with a better overall operational business performance, especially on the fuels distribution and then Comgas resulted in a 350 million cash generation in this quarter.

Turning to page nine, to debt and leverage. The Cosan's gross debt ended the 2Q 4% higher than the 1Q, mainly driven by Raizen Energia's temporary working capital increase in the beginning of the crop season. The consolidated debt profile is mostly concentrated in mid and long terms with cost equivalent to 94% of this CDI. This number also includes the hedge cost related to the US debt.

Now talking about cash generation and leverage. As I mentioned before the cash generation on the 2Q was 350 million, leaving to a pro forma cash and cash equivalent of 4.1 billion in the end of the quarter. The pro forma net debt was 10.7 billion, and the leverage on the quarter reached 2.9 times EBITDA. The slight increase on this leverage -- on this quarter, does not impact our plan to reach 2.5 times net debt-EBITDA by the end of the year.

Now turning to page 10, and talking about guidance. There is no changes in the guidance this quarter. What we're doing here as agreed on the previous quarter, we are only including Comgas guidance, the normalized EBITDA increasing from 1.3 billion reported on last year 2014 to 1.4 billion this year, when we consider the midpoint of the guidance.

Now, once we already -- are halfway through 2015, I also would like to share how we internally -- how we are seeing the performance in our businesses for the second half of the year. So going business by business, on Raizen Combustiveis, the fuel distribution, due to the economic slowdown and higher unemployment rates especially in major driven series, we are expecting results that are pointing between the center and the bottom of the guidance.

On Comgas, all metrics are pointing towards the center of the guidance, as well as Lubricants and Radar business. On Raizen Energia, the crushing volumes, the ethanol and sugar production, as well as the Energy Cogeneration sales and EBITDA are all pointing between the mid part of the guidance and top of the guidance. So overall, as a result of everything I just said, the Cosan S/A consolidated figures for 2015 still pointing to the center of the guidance.

With that, I now conclude the presentation and we are here available to start the Q&A session. 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 Rodrigo Mugaburu, Morgan Stanley. Mr. Rodrigo, your line is open.

Q - Rodrigo Mugaburu {BIO 20980025 <GO>}

Yeah. Thank you. Good morning, Nelson. A quick question on ethanol strategy on the sales. Last year, Raizen build large inventories waiting for higher prices, whenever that -- early this year you said that strategy might change this year. So now with how the market has evolved so far, do you still think that you will be selling all of the ethanol during the second half of the year or you might build inventories through the interharvest? Thanks.

A - Nelson Gomes {BIO 7487048 <GO>}

Rodrigo, what we said at the beginning of the year is still valid. We're not going to build up inventories as we did on last year, but we will follow what the market will do this year. If you look at the inventory levels that we have at this point, at the beginning of the crop season, it's similar to what we had in the same period of last year.

Q - Rodrigo Mugaburu {BIO 20980025 <GO>}

Thank you.

Operator

Our next question comes from (inaudible).

Q - Unidentified Participant

Hi, good morning. I had a question on the fuel distribution business. So, more longer term, the medium term, let's say in 2016 and 2017, do you expect EBITDA growth to be stronger as this (inaudible) even if volumes remain a little muted, let's say in the -- below 5% range. Do you see there is scope for efficiencies and season [ph] EBITDA growth beyond the volume growth in the medium term? Thank you.

A - Nelson Gomes {BIO 7487048 <GO>}

What we see on the long run for the fuels businesses is, still -- we are going to still implement the white flag, the white pumpers conversion that we have, so we still have a lot white flag service stations out there that can be converted to major brands. So this is part of the strategy, and that we remain in the following years. So some of the growth will come from those investments. And specifically on margins, other than fields, we have the

known fields which is convenient stores, for example, that will keep on growing as well. So we do expect additional growth for the coming years.

Operator

(Operator Instructions) That concludes the question-and-answer session for investors and analyst. Now I turn the floor back over to Mr. Nelson Gomes.

A - Nelson Gomes {BIO 7487048 <GO>}

Well, once again, thank you all for attending the call, and we'll talk again on the next quarter. Thank you.

Operator

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

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