Q1 2009 Earnings Call

Company Participants

- Marcos Lutz, CCO
- Paulo Diniz, CFO and IR
- Unidentified Speaker, Company Representative

Other Participants

- Gustavo Gattass, Analyst
- Patricia Fernandes, Analyst
- Pedro Herrera, Analyst
- Unidentified Participant, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to Cosan Limited and Cosan SA's First Quarter 2009 results conference call. Today with us we have Paulo Diniz, CFO and Investor Relations Officer; Pedro Mizutani, Chief Operating Officer; Marcos Lutz, Chief Commercial and Logistics Officer; and Felipe Jansen, 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 Limited and Cosan SA's remarks, there will be a question-and-answer session for industry analysts. At that time, further instructions will be given. (Operator Instructions)

Before proceeding, let me mention that forward-looking statements will be made under the safe harbor and Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of Cosan Limited and Cosan SA'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 Limited and Cosan SA's and could cause results to differ materially from those expressed in such forward-looking statements.

Now I will turn the call over to CFO and Investor Relations Officer, Paulo Diniz. Mr. Diniz, you may begin your conference.

Paulo Diniz

Good morning, everyone. Welcome to this joint call for Cosan Limited, listed on the New York Stock Exchange under the ticker CZZ and its subsidiary in Brazil, Cosan SA listed on the BOVESPA Stock Exchange under the ticker CSAN3.

Mirroring what happened to the whole industry, we also had a tough harvest stock, although totally aligned to the guidance previously released to the market. Although sugar prices continue on a rapid recovery process, the ethanol prices despite better than a year ago dropped in relation to the last quarter. On the production side, the intense rain in April and May affected the sucrose content of the sugar cane and pressured up the production costs. What's more, the reais appreciation in the quarter impacted adversely the results of exports.

On the top of that, the cost inflation inertia also hit the expenses in terms of labor, which were adjusted by the trading unit negotiations at the beginning of the fiscal year and in terms of freight inflating said expenses mainly with regards to exports. This series of negative events in a tough (inaudible) quarter to reprise its approach for the fiscal year. Therefore, the Company started our inventory buildup program for ethanol and mainly sugar in order to profit from or the high financial incentives that the market is giving for those willing to carry the product.

Additionally, concerted channel efforts toward our production mix more ethanol-oriented. Naturally that strategy ended up reducing the sugar sales in the short term, weakening even more the dilution of fixed costs and pressuring[ph] the short-term results. The heavier ethanol-oriented mix implied in higher sales and inventory of this product, with total revenues of BRL640 million in the quarter. That is an 80% increase over (technical difficulty) last year representing 338 million liters of ethanol and 792,000 tons of sugar.

When adjusted by hedge, revenues presented a modest growth of 1.45 because the locked sugar prices in the beginning of fiscal year '08 presented gains of both in this quarter. Due to the low sucrose content in the sugar cane, the cost of goods sold of BRL626 million presented a growth of 14% in (inaudible) of BRL85 million went up 40% due to freight increase and a much higher volume for ethanol exports. Therefore, EBITDA of BRL24.7 million in the First Quarter was 50% below the one booked in the First Quarter of last year. And even if I adjust by hedge, the EBITDA of BRL70 million was 47% below the one accounted for in the same quarter of last year.

This expressed reduction in EBITDA made it impossible (technical difficulty) for us to grow the depreciation charge due to new investments in plantation and the goodwill of past acquisitions. Consequently the negative bottom line of BRL58 million in the quarter comparatively to the cost of BRL13.7 million we issued in the Second Quarter of last year, was a loss[ph] -- totally aligned to our budget and to the guidance we gave previously.

It should also be noted that in this First Quarter, Cosan SA signed important contracts for the sale of (technical difficulty) from its mills Bonfim, Jatai, Diamante[ph]. And Univalem.

In terms of Cosan Limited, the parent company basically reflected what happened to Cosan SA that is a harvest to start with crushing slowed down by rain, mix-oriented total ethanol and inventory buildup strategy. Therefore, ethanol sales by region almost 90 million gallons or a growth of 42% in relation to the First Quarter of last year.

In terms of sugar, due to the inventory build up, it was (technical difficulty) 5% drop in sales volume, which amounted to 790,000 tons. The erratic improvement on international sugar prices and the reais appreciation in the local sales converted into dollars, culminated in posting a growth of almost 20% in the unitary sugar price of US$12.44 per lb. and almost 24% in the ethanol unitary price of $1.66 per gallon.

Therefore the company's revenues of US$394 million presented an expressive growth of almost 31%. However, the same foreign exchange factor that enhanced local sales converted into dollars has also enhanced costs and expenses originally denominated in reais. Besides that, our lower sucrose yield in the sugarcane affected negatively the production in the quarter, as already mentioned.

Consequently at the end of the First Quarter, Cosan Limited booked EBITDA of $14.6 million, margin of almost 4%, result 43% lower than the one booked in the First Quarter of last year. On the other hand, this translation gain on the dollar-denominated debt implied in the financial revenues that contributed to absorb part of the assets depreciation of charge. Also considering the tax shield of the loss before income tax from Cosan SA. And the minority's participation, Cosan Limited ended up the quarter with a net loss of $29.3 million (technical difficulty) cost of $1 million in the First Quarter of last year.

In terms of capital structure, taking into consideration CapEx of almost US$170 million in the period, Cosan finished the quarter with US$82 million, US$83 million in terms of net debt and a net worth with minorities of $2.9 billion. In this capital structure, there is also a healthy cash provision of US$890 million.

So these were the main highlights (technical difficulty) for Cosan Limited and Cosan SA with regards to our First Quarter of 2009 fiscal year. So let's open now for Q&A.

Questions And Answers

Operator

(Operator Instructions) ABN.

Q - Unidentified Participant

Just one quick question. I guess assuming sugar prices and ethanol prices stay at current levels, one year from now with SA with the cogeneration, with all the projects going on, where do you expect your leverage to be at one year from now?

A - Paulo Diniz

Basically for us what is important is to keep a healthy capital structure. Therefore, we are not going to be doing anything crazy in order to pump up that. Therefore, this balanced capital structure increase, there is no business of sugar and ethanol like you are saying, although very, very unlikely in our way of seeing things. Perhaps we may consider to have a strategic or financial partner in some of our projects. For example, (technical difficulty) or even the cogen.

But again, considering the amount of cash that this distribution business and also the cogen business shall be pumping up when they come to a stabilized year, again, we are talking about total potential cogen BRL600 million plus. And in terms of actual (inaudible), BRL300 million plus. I guess that we definitely show[ph] change completely the company to another level.

Q - Unidentified Participant

Okay. Thank you.

Operator

(Operator Instructions) Goldman Sachs.

Q - Unidentified Participant

Thank you very much. Good morning. And first question is really on your operating performance. You were very clear in the drivers as why profitability was lower. Lower TSR, inflation, commodity prices. And exchange rates.

I was wondering, could you give us an indication how much the impact of each roughly is? For example, the TSR was the largest contributor or the yields to lower profitability. But is it like in the range of 50%? Then also for inflation, commodity prices and exchange rates, how important they were for the year-over-year change? Thanks.

A - Paulo Diniz

Not sure if we are going to be able to answer that now because any percentage is always having something else as a benchmark. And one thing is to have I don't know for example our initial budget as a benchmark, another one is to have our current forecast as a benchmark. Another one is to have less (inaudible) as a benchmark. But basically on the yield side, if you calculate the industrial productivity in terms of -- the industrial yield in terms of reais per ton of crushed cane, this is totally aligned to our budget.

Therefore, all the cost (improvement) came from a lower ATR, from a lower sucrose content. Therefore even if we have the same costs, industrial costs in terms of ton of sugar cane crushed, when we apply that across in terms of ATR, we have an increase -- and again, this is basically because we have almost a 9% or so of lower APR, lower sucrose content so far in the sugarcane. I don't know if there is any other points here that someone wants to add.

A - Unidentified Speaker

Yes. This (inaudible) agrees that the manufacture but also in terms of freight for ethanol, we have several increasing (nominal) gallons of freight due to huge competition for trucks during this quarter. We think that competition for trucks also from other ethanol producers. But also from BOD, the producers in the North and Northeast regions of Brazil. So yes, they had a huge impact in selling (technical difficulty).

A - Paulo Diniz

I guess what is important here is because we had much higher volume in terms of exports than we did the whole country. What happens at the end of the day is that on the top of your contracted freight, you end up hiring spot freight. And the price of freight on a spot basis is much, much, much higher than on the contract freight. Therefore, this is also impacting the results in this quarter.

Q - Unidentified Participant

Okay. Thank you. On the -- turning to cogeneration, you made several announcements in the quarter. Could you wrap together for me how many projects you have got under way and how many you are planning to initiate? Then linked to that, how much CapEx have you spent in cogeneration to date? And for active plans, where you are going to be selling -- do you have agreements to sell out of trustee, how much do you plan to spend going forward? Thanks.

A - Paulo Diniz

Okay. Basically what we decided to do here at Cosan was to divide it, our mills in -- as far as cogen is concerned in phases 1, 2 and 3. Phase 1 is basically everything that we had (inaudible) signed contracts. It doesn't matter if it's a bilateral contract or contract coming from the auction. So this phase 1 comprises of six mills constructing to have five more (inaudible) Bonfim, Basa, Barra, (inaudible).

We would have a 37.3 million tons of crushing capacity. Sorry -- 27.2 million tons of crushing capacity. That would represent installed capacity of 547 megawatts of power and that would imply a total of 2500 megawatt hour in terms of energy (technical difficulty) sold. And out of that, we had results basically 1.4 thousand megawatt hours and we are still left with 440 megawatt hours in order to operate on the spot margin.

So for phase 1, we are talking about a total CapEx of BRL1.3 million and we have average price contract of (technical difficulty) BRL57 per megawatt hour. So this is basically phase 1.

Phase 2 was basically comprising everything that was under negotiation and the first one was released yesterday or the day before yesterday. It was phase 2 that comprised revenues of Ipaussu, (Diamante), Junqueira. And Univalem. So we are talking about here another 10 million tons of crushing capacity, representing our installed capacity of 210 megawatts (technical difficulty) and basically implying at total of 675 megawatt hours in terms of energy, (saleable) energy.

And that also implies almost BRL700 million of CapEx. We were planning (inaudible) per megawatt hour here around BRL150. We start in a better way like we announced two days ago (technical difficulty). And two phases, one and two concerning the energy that has already been negotiated plus what is available to be traded on a spot basis would come up to a total of roughly BRL350 million being BRL250 million already -- let's say coming from the phase 1 and another BRL100 million coming from this phase 2.

So this is basically what we have let's say on a concrete basis and then of course we have phase 3 that encompass all other our (technical difficulty) and the other margins of the greenfields.

Q - Unidentified Participant

That was fantastic. That was very clear. So how much CapEx have you spent to date? Then that will leave the balance.

A - Paulo Diniz

We have expensed already BRL630 million to date on the cogen of that BRL2 billion that we mentioned that would imply phase 1 plus phase 2.

Q - Unidentified Participant

Okay and what is the target return that you think you will be able to achieve given the auction rates you are achieving and then the balance on the spot market that you anticipate?

A - Paulo Diniz

Well back of the envelope calculation, we are talking about here EBITDA of BRL350 million against a CapEx of BRL2 billion. Of course that is -- it can be increased by using more leaves on the sugarcane, therefore, by producing more energy because we are considering (technical difficulty) that we will be producing energy just for 6.5. So less than seven months a year. Of course that this can be enhanced with the use of leaves. Thank you.

Q - Unidentified Participant

Okay. Great. Thank you very much.

Operator

MetLife.

Q - Unidentified Participant

Good morning. Just a question on the industry side to see your view on the competitiveness of Brazilian sugarcane production with this real level and if there is any other country today that has lower cost of production?

A - Unidentified Speaker

Paulo, do you want me to take that one?

A - Paulo Diniz

Please.

A - Unidentified Speaker

The reais versus dollar changed a little bit in the last two days. But actually improved a lot on that term. But let's imagine that the reais on the long run at 1.6 level, which is something we internally don't believe is sustainable but at those levels, you will see places worldwide that could -- very small places for instance in the Caribbean area that could produce close to these levels. But besides that, we don't see much.

And the big major difference is not specifically on this competitiveness because the problem is the opportunity cost. When you see the competitiveness of the sugarcane industry, you must also understand that Brazil is the only place that you can have very large expansion areas for the future. There is a steady growth for the sugar consumption worldwide about -- let's say 3 million tons of sugarcane a year, which is something we've been seeing the last years. And you also see a very large consumption growth on the ethanol side.

So when you get to real large expansion areas, you really don't see anything besides Brazil that can make a big difference when you talk about energy industry, Brazil is the only player that can actually be very, very large on the cane industry. You can have the grains like corn and wheat and -- or beets for the sugar. But this is by far less competitive than the sugarcane-based production.

So making a long story short, I don't see places being more competitive than Brazil. Brazil still has a very steady improvement on the efficiencies being conquered every year on a steady basis. And we do see the level of the dollar at 1.6 really not sustainable. So that's it.

Q - Unidentified Participant

Okay. Thank you. Just a follow-on on that. Do you think that as time goes by the international price should reflect more and more the Brazilian cost given Brazil's large share of the export market?

A - Paulo Diniz

I did not get the beginning. Is it sugar or ethanol you've asked?

Q - Unidentified Participant

Sugar. But it could be both.

A - Paulo Diniz

On the sugar side, basically you see the marginal producer defining the price. Normally -- historically what you see is the marginal producer defining the price. Therefore let's say if there is a need toward the output of a producer that is let's say 10 points more expensive than Brazil, the price should be at 10 points higher than Brazilian cost of production.

If the marginal producer is somebody that is 100 points above Brazil, this is a guy that will price the market. That is kind of the dynamics of the commodity prices when you don't have the financial plays being too big. Obviously you know better than I do the financial players on the commodity markets have been more and more active and defining very different patterns compared to what we usually have seen.

But at the end on the expiration date, normally the markets merge -- I mean the financial plays and the physical market have to merge and they can't come to reality. So what I told to you applies on the expiration date of the screens -- for the sugar.

On the ethanol side, you have the big producer of ethanol now being US, with a big consumption. Then you have Brazil as the second big producer but all the exporter being also a big internal market. So you have or US or Brazil defining market price probably and when you talk about an international markets, it will be Brazilian price defining in our view the international markets.

And US will open to arbitrage when the international market will actually have a positive arbitrage to enter US with whatever barriers they have. So that's the design (inaudible) we foresee.

Q - Unidentified Participant

Okay. Thank you.

Operator

Gustavo Gattass, UBS Practical.

Q - Gustavo Gattass {BIO 1702868 <GO>}

Good afternoon, guys. I just had a very quick question about some of the things that were said on the Brazilian call and basically a little bit of the outlook. When we were talking a little bit before you guys mentioned both the possibility of having a larger cash position in Cosan SA. And the fact that many of the producers of sugarcane were seeing rather tight conditions as far as the amount of money that they were getting for the costs that they were facing. My question here is more in the sense of when we spoke about potentially having more cash in Cosan, the focus appeared to be more geared towards Esso Brasileira.

I was wondering if you could go a little bit into what we see as potential to go even beyond that further into acquisitions or consolidation and if you think that from now to the year-end we actually might hear something on that front?

A - Paulo Diniz

For us, Gustavo, it is extremely important to keep a very balanced capital structure. Therefore, we are not going to be doing crazy things even if it could appear to be something fantastic. Today I don't have to comment on what is going on in terms of international finance markets. Therefore, we would rather prefer to keep -- to do what we are doing.

Perhaps one of the terms that we have is of the other players is that in case of major acquisitions, if you like, major measures, we could use our share as a currency. Because these are not despite (technical difficulty) opportunities, because of what is said. I guess we would be having difficulties to do more acquisitions where you know people would like always to receive as a payment cash. So these I would say at this point in time is not recommended to move forward.

But any relevant acquisition, any major acquisition that implies shares instead of cash, of course, that would again would be taking our very, very serious look. (technical difficulty) players in this sector, they know the value of their assets and they know that the current value is extremely under valuated like our share price. Therefore, they do understand the upside and of course some of those players would be willing to take share -- to receive shares because they know what the real value of that asset could be.

Q - Gustavo Gattass {BIO 1702868 <GO>}

Okay. Thank you.

Operator

Pedro Herrera, HSBC.

Q - Pedro Herrera {BIO 15159561 <GO>}

Could you give us an update on the status of the Esso acquisition, financing, integrated, consolidation, etc.?

A - Marcos Lutz {BIO 6779636 <GO>}

It is Marcos Lutz here. We -- update because obviously we still have many ties with ExxonMobil in terms of disclosures. Everything is going well. It's a very -- let's say ambitious plan. We have a big stack[ph] of migrating lots of systems and renewing a lot of systems especially the IT area is very, very challenging. But everything is going on schedule. Everything is going well in the operations as well and the operational side results are above budget. So everything is going pretty well.

Q - Pedro Herrera {BIO 15159561 <GO>}

Okay. Thank you.

Operator

Patricia Fernandes, Itau.

Q - Patricia Fernandes {BIO 21349526 <GO>}

Good afternoon. I wonder how is your hedge position and if Cosan (inaudible) could be able to benefit from the sugar higher prices.

A - Paulo Diniz

Do you want to comment?

A - Unidentified Speaker

Okay, we did not -- Paulo, I can comment but I don't know how far I can comment. So maybe you should guide a little bit.

A - Paulo Diniz

Okay, we put -- we do have the qualitative data here and then you can discuss the qualitative part.

A - Unidentified Speaker

We have in the quarterly (inaudible) -- a favorable comment on that. We have around 2 million tons of sugar with fixed prices in the level of BRL0.1442. This level is expressed between several screens. But we (technical difficulty) in October '08 and March '09. This is close to let's say 80% of our sugar volume for this fiscal year. But for the following year, as we were talking about just roughly 20% of the volume was fixed prices.

Q - Patricia Fernandes {BIO 21349526 <GO>}

Okay. Thank you.

Operator

Thank you. At this time, I would like to turn the floor back to Mr. Diniz. Mr. Diniz, you may conclude the conference.

A - Paulo Diniz

So the investors and analysts, we end here our call, our call (technical difficulty) First Quarter of 2009 fiscal year. Once again, we thank you very, very much for your presence and your continued support. Thanks. Goodbye.