

Q3 2008 Earnings Call

Company Participants

- Paulo Diniz, CFO, IR OFFICER

Other Participants

- Bevan Rosenbloom, Analyst
- Chris Agnew, Analyst
- Eric Ollom, Analyst
- Marc McCarthy, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time, I would like to welcome everyone to the COSAN Ltd. and COSAN SA Third Quarter '08 results conference call. Today with us, we have Paulo Diniz, CFO and Investor Relations Officer; Guilherme A. Prado, Treasurer; and Alexandre Sirihal, Financial Planning Manager. (Operator Instructions)

But 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 beliefs and assumptions of COSAN Ltd. and COSAN SA's management and on information currently available to the Company. They involve risk, uncertainties and assumptions because they are related to future events and therefore depend on circumstances that may not have -- may 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 Ltd. and COSAN SA and could cause results to differ materially from those expressed in the 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, to everyone. This is our earnings release joint call for COSAN SA listed on the Bovespa Stock Exchange since November 2005 and its parent company, COSAN Ltd., listed on the New York Stock Exchange in August of this year. We will try to be very brief in our initial comments so that we can have more time for questions and answers.

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As far as COSAN Ltd. is concerned, the Third Quarter presents a fairly similar situation in terms of prices. (inaudible) in the first and Second Quarters, there was production surplus of sugar and ethanol (remains) which have caused the prices of sugar and ethanol to continue in three markets. We've (been just saying) that there's no price lag or essentially cannibalize the results of COSAN Ltd.

However, from the end of the Third Quarter on, the price of sugar began to rise dramatically as if (dipping the coppund from fundament). Despite the many variables involved, it became clear the way of investors in the search of (basis) ports for the following US dollar with commodities -- especially those commodities with low price, such as the sugar being a (good back). Thus, the average New York (11) price of \$0.10 and \$0.63 per pound in the Third Quarter ended feeling a significant increase and currently it exceeds the buyer of \$0.13 and \$(0.50) per pound (unextrapolated).

(People watched) this environment of depressed prices but with a very promising horizon that COSAN Ltd. recorded net revenues of \$376 million in the quarter, being 19% below the \$463 million recorded in the Third Quarter of last year. Although the reduction is running as reflected in the drop in cost and the reduction of price has been partially passed to the military costs, the extension of the harvest through December until Christmas due to the heavy rain brought low yields and low productivity of production resources over cost elements that are originally (easy on), which in a slight increase in (total off) and consequently in a reduction in gross margin to 90% in the quarter.

Considering that the SG&A expenses the quarter went up by 17% and 14% respectively compared to the Third Quarter of 2007, also due to the dollar exchange rate depreciation of 17% in the period, the (XPA) of COSAN Ltd. closed the quarter at \$12 million, representing a margin of only 3%. Despite the positive effect of the recent (run leadoff) in sugar prices which started by the end of Third Quarter, the temporary accounting effect in the third is not increasing.

The net financial expenses totaling \$131 million in the quarter, mainly inflated by \$107 million plus marking to market (at their speed of pending) transactions for 2.1 million tons of sugar. Naturally, this impact is temporary, being reversed in the coming months, either through higher prices or reversal of the money sense to cover (March calls).

In view of the depressed EBITDA and the making of market adjustments of sugar hedging, the quarter reported a negative amount of \$16 million. And it is important to emphasize this net loss is totally according to our plan and we even find that through the guidance we released in the past and also to COSAN Ltd.'s IPO offering memorandum when we stated on page 58 that the Company expects a net loss for our fiscal year 2008 which closed next April.

As far as COSAN SA is concerned, naturally the Company ended up with the same GAAP (its life) in its Third Quarter. Despite the recent change in the price level of the market, this offer ended up reflecting the average with market conditions (prevent) until then with sugar supply in excess and low prices. Consequently COSAN SA opted to sell only 629,000 tons of sugar, 31% less than in the Third Quarter of last year with an average price

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of BRL441 per ton. As a result, we constantly ended up building a relevant inventory of 865,000 tons.

In terms of ethanol, the position was opposite. COSAN used export as a way to increase sales (inaudible) the local supply and maintain prices under the mass market. The 483 million liters were sold at an average price of BRL738 per thousand liters. As a reflection of this (acceleration of) approach of the first two quarters of the year that is during the harvest period, COSAN ended this quarter with stocks of 10 and 12 million liters.

In terms of the net operating revenue in the Third Quarter sum up to BRL674 million but 30% below the Third Quarter of the previous year. However, part of this reduction in revenue was mitigated by -- directly with management and helped by the Company with regards to its sugar business in being able to book a gain of BRL93 million with such transactions in the quarter.

Another bad impact was the lengthening of the season 2007/2008, (8) in the amount of December until Christmas due to the heavy rainfall as mentioned. First off, in (loan news), it's lowered the (culture) and industrial productivity. Thus, the average cost of goods sold remains at high levels. So the (ATTA) was practically nonexistent in the quarter. Consequently, the EBITDAH of BRL94 million primarily reflected the (inaudible) just mentioned, posting a 12% margin.

Given the unusual appreciation of the dollar in the quarter, the financial result was also penalized by unfavorable exchange rate valuation over the dollar-denominated debt. (Because quite frankly) and based on what we have said, (inaudible) we reported on that loss of BRL71 million in this Third Quarter of 2008. Again, it's important to mention that this negative brought online is totally aligned with the plans of the Company.

Well those were the highlights for COSAN Ltd. and COSAN SA with regards to our Third Quarter. Before we open for questions and answers, we would like to say that we found ourselves in acquiring yields due to the exchange offering program. Therefore, we might not respond to certain questions or even partially respond to some other ones. Therefore, we thank you for your understanding with regards to this matter. I guess we can go to questions and answers, yes?

Questions And Answers

Operator

(Operator Instructions) Bevan Rosenbloom, ABN.

Q - Bevan Rosenbloom {BIO 18494820 <GO>}

A couple of questions. My first one is, what is right now your total unit cost of producing sugar? And my second question is, given the current exchange rates you guys see, how has Brazil's competitiveness in sugar changed?

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A - Paulo Diniz

Well basically, if we do, we have the money. Basically if we do take a look at our cost of goods sold, cost of productions for the first, second. And Third Quarters of this year, we're going to come up with a cost of BRL394 per total of sugar equivalent. And in this last quarter so in the Third Quarter, we looked at the cost of BRL390 per ton of sugar equivalent. So this is basically the production costs to debt we had actually usually in the current levels of let's say debt/cost elements therefore price in our production process.

As far as our competitiveness, first that by agreeing not only that the largest but perhaps the incremental producer of sugar in the world, sugar prices down the road, they tend to - they stabilize in (a land where war) is the sugar profile at least (inaudible) return to Brazilians and other similar cultures as far as cost level is concerned. Therefore, one of the reasons that we made that (policy) up, one, we have a huge discrepancy between the sugar fundamental and effects if you like nowadays, is because somehow the investors and even the market (inaudible) anticipated that don't grow with prices at \$0.10 per pound. Not even Brazil would survive. So there would be no sugar anymore in the world.

So they just anticipate the fact that all the sugar industry should be very fine in the next year. This is our reading. But you understand it's difficult to keep production sales production and reduction instantly in cost when the dollar starts to go under BRL2.5 to BRL1.9, BRL1.8, BRL1.7 and now basically slightly under BRL1.7.

Q - Bevan Rosenbloom {BIO 18494820 <GO>}

Okay, that's great. Thank you very much.

Operator

(Operator Instructions) Eric Ollom, ING.

Q - Eric Ollom {BIO 4374335 <GO>}

(Funny). Could you just discuss for us the global ethanol markets at the current price of energy in the United States, are you able to penetrate the ethanol market, even though you have all these tariffs as well as you mentioned in your press release about the European ethanol market. Could you just discuss what if any sort of penetration you have been able to achieve there?

A - Paulo Diniz

Basically, as far as the ethanol market is concerned, last quarter, we really sold a very relevant amount. It was by far a record quarter. Also in terms of export, we almost (fixed) quarter you know the price of what we had this quarter in the Second Quarter of last year.

Now, it's also facing a funny situation if you like basically because the whole industry is still in its embryonic state. We have the local markets in Brazil that we stand for 80 or perhaps a bit more of the total local production in Brazil and another 20% exported. The local

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market continues to be very, very robust. We are foreseeing a (premental) market this year of 3 billion liters is likely perhaps under that but I know. That's like 3 billion liters.

In the state of Sao Paulo, which is by far the most important state here in Brazil, the consumption of ethanol has already surpassed the consumption of gasoline in 60-40. (Respecting) the whole country, it's also 50-50 coming there in the coming months. And we still have very, very sizable price difference between ethanol prices and gasoline, not only because we continue to have a very fragmented landscape of ethanol producers with a very low bargaining power when dealing with a few distributors and also because again on the other side of the table, we have four or five fewer distributors with a much higher bargaining power.

And on the top of that, we also have the (presently) here in the local market that basically regards to what happens to the oil price. You know because unit price, that is somehow leveled by Petrobras, continues to be in the same price that has been for a long, long time. And of course, I do have the dollar devaluation that helps, to (inaudible) at that price. My point is that again, oil prices are in over \$100 a barrel. Therefore, depends on too who you talk to. You have 6 to up to 25% gap on what should be the gasoline prices here in Brazil.

Well as far as the international environment is concerned, despite all that huge pressure on oil prices what happens in reality is that we do not have I don't know a mark on a worldwide basis. Therefore, you have two countries, Brazil and the US, responding for them roughly 70% of the market, perhaps a bit more and that's about it. Then you have China growing. But that's it. The US is protected. So when we say that we freeze our exports to Europe, yes. But it is real on a -- let's say on a niche basis, you know basically targeting some councils like Holland or even Swedish councils that are perhaps much more environmentally cautious than other countries.

In terms of the US, the US, we export (inaudible) to the US. And we have the benefit of perhaps booking a lower margin with those exports. However, when we seek the strategic importance of those exports, they are very, very big because they do help to let the local market seem much more tight and also in a way that we can keep the price level locally in Brazil. I guess the major competition of oil prices is really with regards to open movements that are happening in the different countries in order to find out solutions in order to face the high oil price.

We know that this is not going to come overnight. But I know people, they start to consider it more much seriously. But again, we have a gap until that becomes a reality in terms of incrementing exports out of Brazil.

Operator

Chris Agnew, Goldman Sachs.

Q - Chris Agnew {BIO 3408258 <GO>}

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First question on inventories. You build them up substantially, thinking the hope of getting better prices. How should we think about Fourth Quarter because back into the early part of next year, your fiscal 2009, it will become the harvest season and presumably prices will come under pressure. So is it fair to assume that inventories you will sell through most of your inventories in the next quarter?

A - Paulo Diniz

Basically yes, we are planning to sell a very relevant part of our inventory in this last quarter. Although, we do have some trading companies that are willing to pay us a premium in order to seek the inventories in here. So we are pausing on those factors and can see what is the (back fund ratio) option that we have. But ideally, we would be selling great part of the existing inventories (pretty much).

Q - Chris Agnew {BIO 3408258 <GO>}

Then you had record auto sales in January and February. I think you gave some numbers in your report about 13% growth in sugar cane crushing capacity next year in Brazil that you are expecting and the majority of that may be going towards ethanol. Do you see demand from domestic demand is growing faster enough to meet supply -- or domestic demand for ethanol is going to meet the supply that's coming on in the next year?
Thanks.

A - Paulo Diniz

Basically, just talking in the local markets, it's really the key driver of all that small supply that you see coming on-stream. And we initially some kind of growth but talking to different car manufacturers today here in Brazil, they're foreseeing 15% to 20% car increase over new cars being sold this year in Brazil. And that is one possible debt.

And also, if you take into consideration that out of those 15% to 20% new car in Brazil, 8% to 85% are flat yield cars and also considering that 60% to 65% of those flex fuel cars and the others are going to be using ethanol and not gasoline. Lastly, if you do take also the assumption that on average a car here, they use 200 liters of ethanol per month, these are going to come up with that incremental market of keeping the liters that I mentioned before.

Therefore, yes, the market is very, very, very unfavorable. On top of that, you do have some hidden pockets of demand that could be somehow managed in case it's needed. For example, you have 20%; 25% of the flex fuel car owners that never ever be used ethanol just because of the historical reasons. And therefore, if those owners they can be educated with regards to the ethanol we also start to use. So this is another 1 to 1.5 billion liters.

Also, in case of VAT tax, we do have a whole bunch of different VAT tax from all the different states here in Brazil. If in the component state, we have a 12% VAT tax, other states like Rio de Janeiro, Minas Gerais that are also important, you start to have 7% up to 22%. Therefore, if we can also have a standardization on VAT tax all over Brazil, that would present another hidden pocket of demand.

So to make a long story short, yes, we are confident that the local market will be able to absorb, create part of that ethanol that is coming on the street. And again, if in the Sao Paulo state, we have ethanol 6% and gasoline 40% of the total fuel consumption, that would be one driver for the whole (inaudible). Yes there is still some markets to be export here in Brazil.

Q - Chris Agnew {BIO 3408258 <GO>}

That's very clear, thanks. One more question please. On cogen, can you update us on the cogeneration plan? I know that you're going to trial soon. Are you thinking would plans be to roll them out to all your mills? And are you currently getting -- making any progress and perhaps negotiating better rights with the electricity companies? Thanks.

A - Paulo Diniz

Let me step back here and go back to 2002 when our pilot plans to develop cogeneration came on-stream. And it was a very successful venture here at COSAN. And basically even nowadays, we're planning that excess energy, although we're small, we're selling that to 50 (fl). So based on that successful story, we answered and we gave direct to sell energy in three moves. (technical difficulties) we starting in 2009.

And because of the trend in (Eastern) Brazil, of course also we studied quickly what would be the impact, what would be the effect with regrets to all our mills. Basically, if we take all our 18 mills plus the Greenfield that we are building, the total installed capacity of our group would reach over BRL1.2000 million. Therefore, basically, COSAN would be among the 10 largest energy producers in Brazil. (Now that's) something very, very interesting.

Of course, that implies a very sizable amount of CapEx. So we are talking about slightly over BRL3 billion in terms of overall capital expenditures. But at the same time, we are talking about EBITDA slightly over BRL500,000 a year. So just (compete) that we are let's say leaving the bank back (inaudible) and we are now conduct some internal series studies in order to make sure that we can cross on this special interest in operations (here).

Operator

At this time, there appear to be no further questions. Marc McCarthy, Bear Stearns.

Q - Marc McCarthy {BIO 1542384 <GO>}

Sorry about that, guys. I just wanted to follow up on the inventory question and then ask if to the extent that you're going to be producing or selling I should say more than 700,000 tons in the Fourth Quarter or I guess the question is, can you envision selling 800,000 tons in the quarter in order to drop your inventory down before the start of the new harvest? Is that a realistic expectation? You mentioned something about a premium of some sort. That would be the first question.

The second question is have you made any progress or any decisions about dehydration capacity in the CBI in any shape and form?

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A - Paulo Diniz

Basically in regards to your first question, basically when we talk about the share amount that we have in our inventory, a great majority of that is really sold to the trading company. Therefore, what is the key in order to accomplish that sale from time to time is making sure that we do receive payments for the goods.

Because trading companies, they do not have the ships there in the port and (inaudible) the (shoes). Sometimes we do have to deliver to a different warehouse or even we are paid here in the (inaudible) our warehouse to keep their inventory. So what on our side determines what if the sales believe it or not is driven in terms of the ownership basically what is key to use the payment from a trading company.

So yes, it's normal. But again, it's going to depend on how the whole market is going to shape up. With regards to your second question?

Q - Marc McCarthy {BIO 1542384 <GO>}

CBI stuff.

A - Paulo Diniz

Yes. Basically, we are still analyzing what is the current state of that you know alternative option (inaudible). What's happening is that on our side, we had decided not to do any kind of these estimates with COSAN Ltd. and feel we have not finished the exchange offer. Because the moment that we do our first investment outside of Brazil through COSAN Ltd., those big companies, they are going to have a different valuation. And COSAN Ltd. immediately will have a different valuation and that would somehow bring much more complexity to our exchange of (inaudible). Therefore, we're delaying any kind of investments at COSAN Ltd. until we have completed the exchange offer.

Operator

At this time, there appear to be no further questions.

A - Paulo Diniz

(This concludes) our call on this Third Quarter and year. And once again, we thank you all for your attentions. Goodbye.

Operator

Thank you. This does conclude today's teleconference. You may disconnect your lines and have a wonderful day.

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