Q1 2017 Earnings Call

Company Participants

- Paula Kovarsky, Director-Investor Relations Officer

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to Cosan S/A's First Quarter of 2017 Results Conference Call. Today with us we have, Mr. Mario Silva, CEO; Mrs. Paula Kovarsky, IRO; Mr. Joao Arthur Souza, CFO and Mr. Phillipe Casale, Investor Relations Manager of Cosan S/A. We'd 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 investors and analysts. At that time, further instructions will be given. (Operator Instructions) The audio and slide show of this presentation is available through the 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 belief and assumption 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 Mrs. Kovarsky. Mrs. Kovarsky, you may begin your presentation.

Paula Kovarsky {BIO 15363001 <GO>}

Good morning, everyone. Welcome to Cosan S/A's first quarter 2017 results conference call. As usual, let's start the presentation by talking about each business line, and then consolidated results. So we can go straight to slide number 4 to talk about Raizen Combustiveis.

2017 started with a few signs of deceleration of the downward trend in fuel consumption seen in the past few years in Brazil. The comparison base is still weak, but the volume in gasoline equivalent, for example, and this is where we adjust ethanol for its energy efficiency, closed the quarter with a 1% growth year-on-year and the total volumes sold decreased only 1% this quarter and this compares to a market that shrank 5% in 2016 compared to 2015, all those numbers are based on the -- ANP data.

A quick -- recap of our strategy, over the last four years, we're focused on the expansion of our network through the conversion of new stations and equally important, the renewal of existing contracts, privileging a long-term partnership with our dealers. In the meantime, we invested to increase the logistics efficiency when start supplying our growing network in a changing environment. And once again Raizen outperformed the market, we call this consistency.

Let's look at the numbers. Raizen Otto cycle sales grew 3% in the first quarter of 2017 versus 2016, while the ANP figures remained virtually flat. Diesel sales remain affected by slower industrial activity in the country. The total volumes sold drop at 6% and 1% according to Sindicom and ANP, respectively. But despite the lower demand during intercrop period, Raizen sales grew 3% due to new contracts on energy and mining industries. Aviation volumes were hit again by lower demand for air transportation, the number of departures fell 7% year-on-year this quarter, according to an ANAC data.

The results. First quarter '17 adjusted EBITDA grew 16% in comparison to the same period last year, reaching BRL682 million. We had a better sales mix with more gasoline, but the main contribution here came from the supply and commercialization strategies as well as cost reduction and efficiency.

I've been repeating myself, but I'd just like to remind you that this strategy goes well beyond the imports, we're talking -- we're talking about inventories management, logistics optimization, trading so on and so forth. For the coming quarter, we foresee a low to mid single digit expansion of the EBITDA and the range will very much depend on prices' volatility and the evolution of demand until the end of the quarter.

Adjusted EBIT grew 27% this quarter, outperforming adjusted EBITDA expansion. We reiterate our view that EBIT better reflects business performance compared to EBITDA, being a better proxy of our search for efficiencies, while reducing invested capital. We actually measure our performance internally based on returns. Raizen Combustiveis' CapEx -- totaled BRL212 million, comprising investments in infrastructure, expansion of the network through the conversion of mutation and the renewal of existing contracts.

We closed the quarter with a total of 6,043 Shell branded stations, implying a net addition of 234 stations over the last 12 months and 16 in the quarter. A quick reconciliation with CapEx here, the conversion base was a little slower this quarter indeed. But CapEx was relatively high because -- in fact, because of some CapEx that slipped from the last quarter of last year. Remember, we said we were expecting CapEx to reach the high end of the guidance in 2016, and we ended up in the middle. So the difference is the CapEx that slipped back to this quarter. And anyway, there's no change to guidance neither for CapEx or conversion targets for 2017.

Going to slide 5, this quarter concludes the 2016-17 crop year, we will therefore discuss both quarter and crop year results in the next couple of slides. Crushing this season was 5% smaller compared to the '15-'16 crop year, reaching 59.4 million tons. This is a reminder, we started earlier last year, crushing nearly 3 million tons of gains still in March and that volume was therefore accounted for in the '15-'16 crop year.

And following up on what we said throughout the year, weather was drier than last season's, benefiting crushing, but taking up all the sugarcane growth. TCA at the end of the '16-'17 crop year, was up 80 kilograms per ton and average TRS, a 129 kilograms per ton. Combining both indicators, the TRS per hectare -- reached 10.3 tons of TRS per hectare in the '16-'17 crop year versus 11.4 in the '15-'16.

Regarding the sales of each product. Sugar sales -- fell 28% this quarter, in line with the commercialization strategy of anticipation -- of anticipating on product sales as defined early in the year, and the total volumes sold in the crop year dropped 9% affected by lower resale volumes. Average sugar prices were higher for both quarter and crop year, growing about 7% in comparisons to the same period of last year.

Ethanol sales were 20% lower this quarter, due to different seasonality as well, but flat comparing full crop year. Average sales price fell 10% in comparison to the first quarter of 2016 due to higher supply availability, but remained virtually flat on year average comparison at around BRL1.7 per liter.

Cogeneration, production and sales of energy shrank 24% in the quarter due to lower biomass availability. Remember again, we were already crushing this time last year. And the yearly reduction was 2%, while the average energy price sold was BRL185 per megawatt hour.

As usual, we adjusted EBITDA to exclude the biological assets variation and debt hedge accounting. This quarter however, we had a negative impact of -- BRL132 million related to an impairment of investments in logistics assets as well as the positive impact of 107 million, reverting the adjustment we made last quarter due to sales anticipation between the two Raizen as disclosed in the earnings report. All considered, adjusted EBITDA fell 36% reaching BRL751 million this quarter.

Looking at the 2016-'17 adjusted EBITDA is reached 3.1 billion, 11% lower than last crop. In both cases, EBITDA drop can be explained by the exchange rate effect in sugar revenues. This accounting effect is essentially the difference between currency hedge and actual exchange rate when we effectively shipped the sugar accounted below the EBITDA line.

Just for you to have a sense, hedged exchange rate for the first quarter of 2017 was of BRL3.73 for the dollar on average, while the average shipping exchange rate was BRL3.12. The hedge gain was therefore a BRL174 million this quarter. And when we look at the full crop year, the effect -- is BRL602 million.

So if we were to include the currency hedge effect from sugar exports back into the adjusted EBITDA, we would have reached 3.7 billion this year versus 3 billion in the '15-'16 crop year on a comparable basis, implying a 25% growth. The EBIT per TRS fell 38% this quarter, reflecting the same negative impact of exchange above the line and higher CONSECANA cost divided by a lower volume. The 2016-'17 average EBIT per TRS reached a BRL180 per ton.

Let me to take the opportunity to talk about hedge. A quick disclaimer to start from this quarter on, we are including the polarization premium in our earnings release for easier comparison. As you can see, we did not advance much on sugar and exchange rate hedging since our last conference call. We actually maintained 1.8 million tons of hedged sugar at an average price of BRL0.72 per pound for the current crop year, the '17-'18. This is equivalent to about 70% of the total amount of sugar to be exported.

The main reason behind such decision was the recent meltdown of sugar prices in our view, the '17-'18 crop season will likely be more balanced -- we'll have a more balanced global supply and demand equation. With that being said, we see no structural reason for such a debacle in sugar prices. It actually feels like there's a view I mean, remember, when prices were going up like there's no tomorrow last year, despite the big long position of the fund and with no counterpart in the physical market.

Let's talk about efficiency and cost reduction on slide 6. Similarly to the analysis we made at the end of the last crop year, let's start with TOTEX, which is the sum of maintenance CapEx and OpEx. The chart I'm referring to is located in the mid-bottom of the slide 6. The green bar reflects the increase of CONSECANA, effect land leasing and acquisition of third-party sugarcane and growing 16% in the '16-'17 crop year versus '15-'16. The blue bar instead excludes CONSECANA linked effect, reflecting CapEx and OpEx under our own control, growing only 4% let alone the fact that sugarcane renewal increased from 11% to 15% this crop year.

Still in the topic and highlighting the ongoing efficiency increase in cost reduction journey of Raizen Energia. The unit cash cost of production in sugar equivalent, excluding the impact of CONSECANA as well, contracted 5% in the first quarter of 2016 and 2% in the crop year, more than absorbing inflation in our own production of sugarcane.

And last but not least, CapEx, we spend 897 million this quarter, 11% more than we did in the first quarter of 2016 and 2.1 billion in the '16-'17 crop year within the guidance. The yearly increase reflects higher renewal of the sugarcane fields to 15%, I mentioned that already. We believe this to be the adequate level for the next few years in terms of sugarcane's field renewal as well as the anticipation of a few mandatory expenses regarding health, safety and environment.

Turning now to Comgas, on slide 7. And since Comgas reported their results this Monday, let's focus on the highlights only. The first month of the year brought a slight recovery of industrial sales volumes, the comparison basis is weak as well, but we had once again, an increase in demand from a -- few clients, in segments such as ceramics, chemical and automotive, resulting in a 3% growth versus the first quarter of '16.

Residential and Commercial segments kept on growing year-on-year 1% and 5%, respectively due to the connection of new clients.

The residential growth however, was negatively affected by warmer weather, reducing a bit the unit consumption. The total volumes sold by Comgas excluding thermal generation grew 3.5% in the first quarter of '17 compared to '16. Comgas' normalized EBITDA grew 19% this quarter and reached 384 million, reflecting the higher volumes sold and inflation adjustment on margins adjusted by the regulator back in May, 2016. I'd like to remind you that tariff readjustments include the annual adjustment of inflation on margins, as well as the pass through of gas costs as provided for by the concession contract.

IFRS EBITDA fell 40% this quarter due to drop in the cost of gas and consequent BRL60 million reduction of the regulatory current account whose balance stands at BRL354 million in favor of consumers. The base of current account reduction going forward will very much depend on the exchange rate and evolution of gas prices as well as on the parameters for reduction to be defined by the end of May as part of the annual tariff anniversary. Comgas closed the first quarter of '17 investing BRL75 million, 20% less compared to the same period last year, but in line with the strategy of higher investments in -- on the next quarters.

Let's go to slide 8, about Moove. The Brazilian markets for lubricant still show signs of contraction on lower economic activity, but Moove kept on outperforming the market expanding in domestic operations by 1% this quarter versus the 1% drop of the market, considering SINDICOM data. International operation -- operations maintained an average growth of 7% on volumes sold.

Moove's EBITDA reached BRL43 million and the growth was supported by increasing share of OEM factory field in Brazil and higher volume in international operations. Now on corporate. General and administrative expenses reached BRL40 million, 5% below the same period of last year and the slide encompasses personnel as well as legal and consulting services.

Moving to slide number 9, where we will present the consolidated results of Cosan S/A on a pro forma basis, i.e., considering 50% of Raizen results. The improved operational performance of Raizen Combustiveis, Comgas and Moove was offset by lower results from Raizen Energia due to the negative impact -- negative accounting effect of the -- effects already explained, resulting in a 4% drop of Cosan's adjusted EBITDA that reached 1.1 billion.

If we were to include the positive -- the hedging gains on FX for sugar exports, on top of the adjusted or on top of adjusting for non-recurring effects also detailed in our earnings release. Cosan's EBITDA would have been 1.2 billion this quarter, calling for a 8% growth in the same comparison basis versus last year. IFRS EBITDA for the first quarter of '17 with no adjustments was of -- BRL974 million.

Cosan net income reached 205 million this quarter versus 247 million in the same period last year. Pro forma CapEx grew -- 5% this quarter, reaching 631 million due to higher expenditure in Raizen, partially offset by a reduction at Comgas. The pro forma free cash flow to the equity reached a 139 million and I'll dig into that number in the next slide.

So let's go to slide number 10, and let me first talk about the pro forma net debt evolution that once again decreased when compared to the previous quarter, reaching BRL7.6 billion. We have reduced the Company's leverage to two times net debt to pro forma EBITDA, which considers normalized EBITDA for Comgas, and the reported net debt to pro forma EBITDA fell below two times as indicated by the green line on the upper right side of the slide. As for our leverage targets for 2017, we believe two times EBITDA to be a comfortable level for the Company on a recurring basis, assuming Comgas' normalized EBITDA.

And just a quick highlight on the consolidated gross debt on a pro forma basis, that fell 5% to -- due to the reduction of Raizen's debt balance and mark-to-market of the perpetual bonds whose principal is no longer hedged. The average cost of debt on a pro forma basis, i.e., including Raizen was of 99% of the CDI and a 102% if we exclude Raizen.

Now, the free cash flow to equity. The main drivers compared to the same period last year were; the 4% higher operational cash flow driven by Raizen Energia as the positive impact of the currency hedging is included, and this quarter also had a lower variation of Raizen Energia's working capital due to the anticipation of the crushing period of last crop year increasing the inventory line.

The cash flow from investments grew this quarter due to the payment of BRL276 million on Rumo shares previously owned by TPG due to the execution of a put option owned by the funds since their investment in logistics business back in 2009. And in the financing -- the financing cash flow, the variation cash flow, sorry -- the variation has to do with seasonality in interest payments mainly from the -- '27 bond. These effects resulted in a lower free cash flow to equity generation of BRL139 million in the first quarter of 2017.

Let's move to the last slide to wrap up the earnings presentation, once again, we show our guidance for 2017. There has been no change -- whatsoever to the numbers presented last quarter. We are actually confirming the guidance for Raizen to the '17-'18 crop year using the same assumptions described in our last conference call.

So this is all. We're ready to move to the Q&A session.

Questions And Answers

Operator

We will now begin the question-and-answer session. (Operator Instructions) This concludes today's question-and-answer session. I would like to invite Mrs. Kovarsky to proceed with her closing statements. Please go ahead.

A - Paula Kovarsky {BIO 15363001 <GO>}

Well, thank you all for joining the call. If you have any further questions, -- please feel free to contact our IR team, and see you next quarter.

Operator

That does conclude the Cosan audio conference for today. Thank you very much for your participation, and have a good day.