

Q3 2018 Earnings Call

Company Participants

- Phillipe Casale, Investor Relations Executive Manager

Presentation

Operator

Good afternoon, ladies and gentlemen. At this time, we would like to welcome everyone to Cosan S.A.'s Third Quarter 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 remark, there will be a question-and-answer session for industry analysts.

(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 relates to the 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 S.A.'s third quarter 2018 earnings conference call. I like to open this call by discussing our recent announcement. As you know, we are constantly analyzing ways to simplify our corporate structure and to create value for shareholders.

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With this in mind, on October 24, we released a material fact informing the market that we have initiated studies to assess the feasibility of incorporating Cosan Logística into Cosan S.A. Immediately after this announcement, we were asked to address the lack of details regarding the expansion and potential accuracy of these proposals.

We acknowledged that the lack of additional information hindered the market's understanding as to how this transaction would assist in the simplification process. Out of respect for the interests and concerns of shareholders and investors, we decided to cancel this transaction. I would like to emphasize here our commitment to best governance and transparency practice to any corporate action we take going forward.

Let's now move to slide four to discuss the business results starting with Raízen Combustíveis. And before entering into Raízen's figures, I would like to remind you that we concluded the acquisition of Shell's downstream assets in Argentina on October 1. Therefore these operations had no impact on our 3Q, '18 results.

The distribution segment also faces some challenge this quarter. Remaining effects of the trucker's strike forced a temporary re-optimization of our supply dynamics, given the lower diesel import's attractiveness. Besides, we had also had the World Cup affecting consumption in July. This challenge demanded additional efforts from our team to again deliver above the industry average results.

Let's look at the numbers. Total sales volumes was up 1.5% compared to the same period last year. The highlighting of the period was diesel, which continues to enjoy above GDP and above industry average growth due to the higher demand from our business clients, coupled with new contracts signed over last year.

Demanding on the Otto-cycle remains below expectations, driven by factors such as the high level of unemployment rate in Brazil affecting families' income and high prices at the pump, especially from -- for gasoline in line with the international oil prices and currency increases. In this environment, we saw again strong growth in ethanol consumption.

Sales volume of the aviation segments grew 9% in line with the sector's resumption. Adjusted EBITDA came at BRL683 million in 3Q '18, 26% higher than 2Q '18 but lower than the same period last year. Remind you that the 3Q '17 comparison basis is strong since it was positively impacted by inventory gains and also prices being adjusted more frequently by Petrobras.

Similar to what we did last quarter, we highlight that in 3Q '18, we had negative impact of around BRL20 million, specifically related to the truckers' strike, which includes the impact of average diesel inventories and one-off logistics costs.

As I mentioned before, despite several challenges faced in the quarter, once again, we delivered consistent results, sustained by our strong relationship with our customers' base.

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Investments in the quarter came to BRL188 million including maintenance, conversion of new stations and renewal of existing contracts. We ended the quarter with 6.444 Shell-branded stations, a net addition to 306 stations in the last 12 months and 84 in the quarter. Our expansion plan remains in line with the expectations for the year.

Now let's move to Raizen Energia on Slide 5. And this is -- this was the second quarter of 2018-2019 crop year. It was marked by rainfall volumes higher than expected, reducing the crushing by 14% year-over-year.

This drier weather during the intercrop season impacted the sugarcane productivity index which reached 9.6 kilos per -- kilos of TRS per hectare and we continue to prioritize the ethanol production over sugar due to higher biofuel profitability and demand this year. Therefore, the ethanol mix reached 51% in the 3Q '18 versus 42% in the same period last crop year.

Let's review sales for each product and we start with sugar here. As you can see in the chart on the right hand side, sales volume came in 28% lower than 3Q '17. We concluded a few sugar storage projects in our mills which provides us with higher flexibility and enables us to maximize the carry strategy for sugar. Average sales price in Brazilian reais came in 30% lower compared to the same period last year, following a sharp drop in commodity price.

The ethanol sales came in 8% higher compared to 2Q '17, driven by higher demand and increased production in the period. Average price improved 10% versus same period -- the same period this crop year, but was in line with the previous quarter.

Now moving to Cogeneration, I like to point out that starting this quarter Raizen is consolidating the result of WX or W Shield (ph) our Energy Trading Company. This operation adds even more value to our portfolio by increasing our offering of integrated energy solutions.

For this reason we are now breaking down volumes between own volumes and resale & trading. Likewise in sugar and ethanol, as these operation results in revenue increase, but with margins substantially lower than the sale of energy generated by Raizen. That being said, all volumes sold were 8% lower, reflecting lower biomass availability due to reduced crushing in this period.

Before discussing EBITDA, I would like to comment on the quarter's cost dynamic. Sugar equivalent unit cash cost excluding (inaudible) effect was up 9%, affected by higher diesel costs, lower agricultural yields and inflation in the period. Raizen adjusted EBITDA reached BRL641 million, a drop compared to the same previous crop year, mainly due to lower volumes in prices of sugar sold.

As we mentioned in our last conference call, our sugar and ethanol sales strategy this year is focused on a higher concentration of sales during the last two quarters of the crop year. While certainly sugar hedged, and we advanced our projections, leveraged by improved prices in Brazilian reais for the third quarter.

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For the current crop in '18-'19, we are nearly 100% hedged at an average price of BRL0.50 per pound. For the next crop '19-'20, we hedged approximately 30% to 35% of the total sugar to be exported with an average price of BRL0.53 per pound. Finally, CapEx totaled BRL465 million in the quarter, reflecting the higher investment in planting and renovation of sugarcane fields, in line with our schedule for the year.

Let's move to Slide 6. Comgas released its results in Q3, so let's go straight to the highlights. Total sales volume, excluding thermal power, grew 9% with expansion seen in all segments. In residential and commercial, we maintained our focus on customer-based growth.

In Industry segment, group sales performance was a result of renegotiation or negotiations to increase volumes in the current customer base. EBITDA normalized by regulatory current accounts grew 14% this quarter reaching BRL546 million, mainly driven by higher volumes sold. We ended the quarter with a BRL161 million balance in the regulatory current account recovered from clients. Thus IFRS EBITDA came in 60% lower due to the gas cost dynamics. Comgas investment totaled a BRL139 million in 3Q, 2018 in line with the year's guidance.

Let's move to Slide 7 and starting talking about Moove. Recent initiatives of our international expansion plan and improved sales performance in Brazil reflected a 4% growth of finished lubricant sales volumes. These are the sales volume, the raw material for lubricant manufacturing dropped in this quarter. An improved sales mix and international operation results in BRL drove the 34% EBITDA growth which came to BRL60 million in 3Q, 2018.

Now let's turn to the right side of this slide. General and administrative expense came in respectively 19% and 16% lower than the same period last year. Other expense increased, but in line with expectations for the year. This item is composed of legal expense in various legal claims.

Moving to Slide 8 to present consolidated results of Cosan S.A. on a pro forma basis, considering 50% of Raizen's results. Cosan pro forma EBITDA came in 25% lower versus 3Q '17, reflecting Raizen's result in a period. Year-to-date pro forma adjusted EBITDA totaled BRL3.6 billion.

Net income in 3Q '18 reached BRL44 million and besides the effects that impacted the operational results or the operating results, Cosan's financial expense were negatively impacted by Brazilian reais appreciation against the US dollar, specifically on the unhedged portion of the perpetual bond. It's worth mentioning that this effect does not impact the cash generation in the period and the year-to-date net income totaled BRL324 million.

Now let's move to Slide 9 where I will highlight the cash flow in the quarter. The lower operating cash flow reflects the impacts we already mentioned at Raizen Energia in line with our strategy of building sugar and ethanol inventories. In addition to that, it should be noted that at Raizen Combustiveis we had an impact of approximately BRL100 million

referring to the diesel subsidy program, which was approved by the federal government after the truck drivers' strike.

Out of that -- out of the total to be received, only 10% was paid and the remaining part is to be disbursed by ANP in the coming weeks, since all the necessary information and document has already been sent and processed by the agency.

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The effects of the operating cash flow in Raizen were partially offset by the improvement in Comgas. In cash flow from investments, there was a higher expenditure of -- at Comgas and please note that here, the comparison base is impacted by the acquisition of Tonon mills by Raizen Energia in 3Q '17.

In cash flow from financing, the highlight was the funding operations at Raizen to pay the \$370 million related to the acquisition of Shell's assets in Argentina. The settlement of this acquisition was held only on October 1, not impacting cash flow this quarter. Pro forma gross investments was up 8% in 3Q '18 to BRL16.9 million, as a result of the funding operations at Raizen. The average cost of investments on a pro forma basis, including Raizen, stood at a 109% of CDI.

Cash balance remains strong, but increase in gross debt lead the leverage from 1.8 times net debt-to-EBITDA to 2 times pro forma net debt-to-EBITDA normalized by Comgas current account effect.

Now let's move to the last Slide and to conclude today's presentation. We are following up, again, with our guidance for the year without changing the consolidated figures. Comgas adjusted the normalized EBITDA range to between BRL1 billion and BRL900 million to BRL1 billion and BRL950 million due to higher volume sold so far in the year and efforts to control expense.

In Raizen Energia, we are maintaining the initial EBITDA projections but we have to adjust the sugar volume produced in line with the reduction in sugarcane crushing and the higher ethanol mix. In cogeneration, we are now showing volume produced and no longer the volume sold, once the volumes of WX or W Shield (ph) our new trading company is now consolidated in the results.

At Raizen Combustiveis we decided to adjust EBITDA guidance to share with your best estimate. This has been a difficult and challenging year. We had a major strike, pre-election uncertainties and lower economic recovery. We have seen a gradual improvement in results during the second half of the year, after the strike, but there are few challenges.

The month's behavior in Otto-cycle with the diesel and gasoline pricings, not to mention issues related to the diesel subsidy program. Therefore we decided to narrow the range keeping the low end of the original projection which is BRL2.850 billion at the mid-point of the new estimate, as this remains our goal.

And note that, we are not adjusting the negative effects of the truckers' strike. Otherwise we would be on track with the previous range. As a reminder, the projections of Raizen Combustiveis do not include Shell's operation in Argentina.

Now this concludes my remarks. Thank you all. And let's move now to the Q&A session.

Questions And Answers

Operator

Thank you. We will now begin the question-and-answer session for Investor and Analysts.

(Operator Instructions)

That does conclude the question-and-answer session for Investors and Analysts. I'd like to invite Mr. Casale to proceed with his closing statement.

A - Phillipe Casale {BIO 20025617 <GO>}

We don't have any questions, but our IR team is more than available here to take any questions from our investors. Thank you very much.

Operator

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

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