Q1 2010 Earnings Call

Company Participants

- Carlos Murilo Mello, Commercial Director
- Marcelo Martins, CFO and Director of IR

Other Participants

- Debbie Bobovnikova, Analyst
- Felipe Hirai, Analyst
- Matt Farwell, Analyst
- Paula Kovarsky, Analyst
- Tereza Mello, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to the Cosan Limited and Cosan SA's First Quarter of 2010 results conference call. Today with us we have Marcelo Martins, CFO and Investor Relations Officer; Pedro Mizutani, Chief Operating Officer; Felipe Jansen, Investor Relations Manager; and (Jolele Soia), Chief Strategy Officer; and Murilo Mello, Sugar Commercial Director.

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)

The audio and slideshow of this presentation are available through live webcast, at www.cosan.com.br/ri. 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 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 and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I'll turn the conference over to CFO and Investor Relations Officer, Marcelo Martins. Mr. Martins, you may begin your conference.

Marcelo Martins {BIO 16440115 <GO>}

Good morning. I would like to start the call today with the information that we have not released US GAAP numbers for Cosan Limited yet as we normally do in every quarter. And the reason for that is the actual consolidation of the NovAmerica business once the acquisition was concluded shortly before we closed the quarter.

We will, nonetheless, release the numbers over the next couple of days, and we do apologize for this having occurred. What you have is the Brazilian GAAP numbers for Cosan Limited, and as soon as we release the numbers we'll make ourselves available to clarify any questions you might have on the US GAAP numbers.

I would like to start the presentation with my -- with some remarks that are the following. First, the -- over this quarter, we had the conclusion of the closing of the NovAmerica deal which took place in June this year. And for this quarter we have one month only of the NovAmerica results consolidated within Cosan.

We also have in the First Quarter of 2010 a different period of time compared to the First Quarter of 2009. The First Quarter of 2010 is comprised by the month of April, May and June, while in 2009 the First Quarter was comprised by May, June and July.

We also have in this quarter a consolidation of three months of operations of CCL, Cosan fuels and lubes, which are now fully integrated within the Cosan Group.

I would like to start with some financial highlights, and then we're going to talk a little bit about each of the respective businesses of the Group.

In terms of the consolidated net revenues, we had a jump of roughly 460% compared to the First Quarter of 2009, resulting for the incorporation of the CCL business, which generate substantially more revenues given the profile of the business than sugar and ethanol. If you compare the sugar and ethanol business with the First Quarter of the year 2009, you will see a jump of roughly 100% in the net revenues.

In terms of the breakdown of the revenues, roughly 60% are represented by fuels, and there is a change in the mix in a sense that with the incorporation of the CCL business, domestic markets represent 80% roughly of our sales compared to 20% of export.

Moving to the financial highlights, I would like to start with the consolidated EBITDA. We saw a deep variation, a jump of 965% compared to the First Quarter of last year. And it's a combination of much higher EBITDA in ethanol and sugar business and the EBITDA -- the full EBITDA of the First Quarter for CCL. CCL had a record quarter with a record margin that we'll talk about in a moment.

In terms of the breakdown of the EBITDA, the CCL business combined with the co-generation business today represents roughly 37% of the EBITDA of the Group. It is very much in line with our strategy to keep growing the co-generation business along with the distribution business. And we're in the ramp-up stage of the co-generation business and we believe that this number should continue to grow over the next quarters and especially the next years as we conclude our co-generation projects in most of our mills.

In terms of the net income, the consolidated net income was BRL337.3 million, which is a record net income for the Company, represented by 9.5% compared to negative losses of 9.1% equivalent to BRL58 million in the First Quarter of last year. This net income was impacted by financial revenues in the amount of BRL433.4 million, which derived from foreign exchange variation and the positive impact coming from the derivatives and the commodities hedging strategy of the Company.

In terms of the CAA business, I would like to start with some market overview. As you may know, we had a good start this year with profits of much better crop compared to last year. But given the heavy rain that impacted the Central-South of the country, especially in the months of June and May, we had a reduction in the crushing of sugarcane and a subsequent reduction in TRS yield, which was in the range of 124 kilo per tonne in last quarter.

At the same time, there is an estimated shortfall of 5 million tonnes of sugar for the 2009/2010 crop in India, which forecasts a total production of 17 million tonnes for the same crop.

Overall, we have major sugar imports being impacted by lower inventories at the same time which have put tremendous pressure on the price of sugar, which has substantially increased, especially over the next couple of months, and we'll talk a little bit about our forecast for sugar prices in a minute.

In terms of the market -- ethanol market overview in Brazil, what we have is a growth of 4.5% in the sale of flex-fuel cars, which totaled 1.474 million units in the First Quarter -- and up to the month of July in 2010. As you probably know, 90% of the new cars sold in Brazil are flex-fuel cars.

In terms of ethanol exports, we forecast exports to be substantially lower in -- in this crop compared to last year as a function of overall better prices in Brazil, even though in the First Quarter we had some windows of opportunity and we ended up exporting more given the delta in the price compared to the domestic market.

Overall, production of ethanol in Brazil continues to be at high level even though we're starting to see some of that production stretching to sugar, given the very high prices, and the formation of stocks being at a lower level than we had last year which will probably result in inter-harvest inventories being lower than last year as well.

In terms of the financial highlights, in the sugar business the volume sold increased substantially and the average price -- unit price went up pretty substantially as well. That resulted in net revenue of 85% higher in the First Quarter of this year compared to the First Quarter of last year.

The average unit cost remained stable. The increase in the cost was a result of higher volumes being sold in the domestic market and in the international markets as well. In terms of the unit gross margin, there was a big jump of 3.4% for the First Quarter of last year to 34% roughly in the First Quarter of this year.

In terms of the ethanol business, volume sold, we had an increase of 124% compared to the First Quarter of 2009. And as I mentioned before, during this quarter, we saw prices in the international market slightly higher than in the domestic market. Therefore, we ended up selling more in international markets. We ended up exporting more ethanol in this quarter than we had originally predicted.

Net revenues were also, of course, positively impacted by the growth in the volume, and they resulted in BRL479 million compared to BRL241 million in the First Quarter of last year. As in the case of sugar, the average unit cost remained stable in this quarter as well.

In terms of the gross margin, as a function of the price of ethanol being low and the cost being stable with margins getting deteriorated to a level of 13.8% negative in the First Quarter compared to roughly zero in the First Quarter of last year.

Overall, CAA presented an EBITDA of BRL218.8 million in this quarter, which represented a margin of 17.8% compared to 4.6% in the First Quarter of '09. The EBITDA hedge resulted in a number BRL379.7 million compared to BRL74.4 million in the First Quarter of last year represented by a valuation of plus 410%.

It is, of course, a result of our hedging strategy. As you know, we monitor the market and we try to keep our margins at a level we consider to be sustainable in this business, and we'll talk a little bit more about our hedging strategy as move forward.

I would like to now switch to CCL. This is our first full quarter of results for CCL. In terms of net revenues, we saw a reduction of 4.1%, and that reduction in the revenues was also reflected in the reduction of cost of goods sold for the fuels and the lubes business as well. Therefore, we not only manage to preserve the margin of the business, but we manage the substantial increases through the -- through obtaining some of the synergies we had anticipated when we closed the acquisition end of 2008.

Out of the net revenues of this business, roughly 81% is represented by the combination of gasoline and diesel, but as you know the lubes business is the business that has the best margins within our portfolio.

Talking about the gross margins of both businesses, in the fuels business we grew the margin by 1% from 4.1% to 5.1%, and in the lubes business the gross margin jumped from 33.4% to 34.4%. The EBITDA margin for CCL was 3.8% equivalent to BRL92.4 million and we're very comfortable to say that we probably have the highest margin in this business.

If you saw the margins that were presented by Ipiranga by Ultra Group very recently, you will see that we have substantially better performance than they did. And we integrated new assets within Cosan, at the same time they integrated Texaco or the Chevron assets they acquired at the same time as we did.

I would like to talk a little bit about the consolidated EBITDA of Cosan. We're coming from BRL29.2 million in the First Quarter of 2009. We had a positive impact coming from the volume price and price of sugar and the volume in the case of sugar and ethanol, and we had also positive impact rise from the foreign exchange variation.

On the other hand, the negative impact coming from the cost is a function of the increase in the TSR, in the sugarcane business of course, and also the increase in the volume in this quarter.

In terms of SG&A, we had a positive impact of roughly BRL8 million and we also took advantage of a capital gain deriving from the sale of the aviation business in the First Quarter of 2010, which was -- which had a zero impact on our net income considering that we amortized 100% of the goodwill of this business during this quarter.

In terms of CCL EBITDA contribution, it is -- it was equivalent BRL92.4 million, which added to CAA to make up for BRL311.2 million EBITDA in the First Quarter of 2010. Adding BRL160 million of gains deriving from our derivatives, we had the total EBITDA of BRL472 million in the First Quarter of 2010.

In terms of our hedging strategy, I would like to switch it now to Murilo Mello, who is our Director for the Sugar Business, who will talk a little bit about not only our strategy moving forward, but our outstanding position for both sugar and FX.

Carlos Murilo Mello {BIO 16627976 <GO>}

Good morning. First of all, I would like to start saying that we have been foreseeing quite strong fundamentals since last year on the supply/demand situation for sugar worldwide. And very recently, we had seen improvement fundamentals yield given some specific events that have been happening.

I would like to mention, like Marcelo said, rain above average in Central-South Brazil generating a lower crushing figure for Central-South Brazil as a whole, as well as a lower sucrose content or ATR in the cane. I would like also to mention rains below average in India generating lower agriculture yield for the next crop starting in October '09 and decreasing excepted production of sugar from -- down from 18 to 16 million tonnes for next year and generating higher import expectations up to 5 million tonnes from India.

Very recently, Mexico just announced a sugar import quarter, as well as we are expecting US to announce soon. So those events, they have boosted sugar fundamentals very positively.

We are seeing some very externalities from the sugar market as well. I would like to mention something that we've been noting as a whole for the commodity complex and risk asset, in general, which is a decreasing risk aversion, giving a boost to all the commodities, especially sugar, given the very strong fundamentals. We also note that consumers' has been eating buffer stocks for a while and now they need to buy irrespectively of the sugar prices.

As well as producers of sugar, in general, not only in Brazil, but in general are facing a shortage of lines of credit for their hedging policies. This sort of things is not necessarily impacting us as aggressively as the market, but many producers just can't hedge and so just can't offer the selling side, counterbalancing the funds and the consumers' buying.

In general, we dedicate a lot of effort in our sugar and ethanol supply/demand, research and marketing intelligence, and we've been quite constructive for sugar prices since last year. That being said, this is the reason we decided to go a little slower on the implementation of our hedging policy since last year and allowing us to participate -- to better participate in recent sugar pricing upside.

Nonetheless, we are now taking the decision to improve the base of our hedging implementation. We understand that sugar margins are quite good and we are moving forward to try to locking in those good margins for part of our sugar production. It doesn't mean that we don't see a sugar -- upside for sugar prices. Fundamentals, as I said, are still quite good and improving, but we think margins are very decent and we are fast approaching the level of -- justified by its fundamentals.

We do not disregard potential spikes on prices or eventual overshooting given the -- especially given the financial community increasing interest on sugar and any trusted situation from fundamental. But given margins are good, we are deciding to move along, accelerating our hedging policy and taking the necessary actions for mitigating eventual margin goals and risks associated with our hedging policy.

That being said, among them, we are making sure that we have the adequate lines of credit and cash in reserve for meeting margin goals and trading hedging with decent adequate counterparty risks.

Marcelo Martins {BIO 16440115 <GO>}

Okay. Thanks, Murilo. Before we finalize our presentation today, I would like to talk a little bit about our outstanding debt. And we have -- we had an increase in our total debt to BRL4.624 billion in the First Quarter of '10 that already include 100% of the debt we assumed from NovAmerica as a result of the combination of both businesses.

We kept the cash position of roughly BRL930 million which resulted in a bad debt of BRL3.7 billion roughly. What we did was to calculate a pro forma EBITDA because as you know well we had only one month of EBITDA for NovAmerica in the result of the business so far, and so we did a pro forma calculation for 12 months based on this month of EBITDA of NovAmerica. And we also annualized the seven-month EBITDA of CCL, which combined provided for net debt to EBITDA ratio of less than 3 times more -- to 2.98 times in this quarter.

The total investments of the Company include the stand-by credit facility provided by Bradesco, which provided us with the option to extend the maturity of the promissory notes by another year. And what is not included here is the $350 million raised through the issuance of bonds by CCL. As we have already explained to the investors, these proceeds will be used to repay debt that was raised by Cosan with a purpose of financing this acquisition. So the $350 million, which is not included in the debt profile, will replace existing debt, therefore, would not increase the total debt of the Company.

In terms of the investments, in the First Quarter we have an increase 15.4% compared to the First Quarter of 2009, and it is a result, of course, of our growing investments in the co-generation business and the conclusion of the investments in the Gasa and Jatai projects as well. The investments even though they represent an increase of 15% compared to First Quarter of 2009, they are very much in line with what we had predicted for this year.

So overall, the notice to the market in this quarter were the association with NovAmerica, the sale of the aviation business that as I mentioned to you during the presentation is already reflected in the results of First Quarter, the hiring of the stand-by credit facility with Bradesco, and the bond issuance in the amount of US$350 million.

With that, I would like to finalize the presentation and open the session for questions. Thank you.

Questions And Answers

Operator

(Operator Instructions) Your first question will come from the line of Felipe Hirai from Merrill Lynch.

Q - Felipe Hirai {BIO 15071781 <GO>}

Hello. Good morning, everyone. This is Felipe Hirai from Bank of America/Merrill Lynch. I have two questions. The first one, like, I wonder if you could clarify to us what was the impact of the sale of the aviation fuel business of BRL93 million in your EBITDA, my question is if that number is included in the EBITDA number of BRL311 million that you reported? And also, if that's included in that number, if that -- when you would breakdown of the EBITDA between the CAA and CCL businesses, if that's included in the CCL or in the CAA business? That's my first question.

A - Marcelo Martins {BIO 16440115 <GO>}

Okay. Well, Felipe, yes, it is included. It does not impact the net income, as I mentioned before, but it is included in the EBITDA and it's not included in the CCL business. It actually impacts the CAA business, but it's offset by restructuring -- by costs related to the reorganization of the Rumo Logistica business, which took place at the same time as the sale of the aviation business. So net-net, we had an impact in the aviation -- I'm sorry, in the CAA business and not in the CCL business. The EBITDA for the CCL business reflects 100% of the result of the fuels and lubes business in this quarter.

Q - Felipe Hirai {BIO 15071781 <GO>}

Okay. And my second question is regarding your hedging policy or strategy. Why -- we saw that you increased a little bit (of your) hedges, we would like to understand better your hedging policy, specifically the reason why you are increasing the number of shorts in calls that you do in sugar. Thank you.

A - Marcelo Martins {BIO 16440115 <GO>}

Felipe, just to clarify because I'm not sure it was your question at all, but the EBITDA of the aviation business was negative in the first half of the year in the -- for CCL. So of course, whatever the EBITDA was up to the moment we sold the business is reflected in the numbers of the Company. But with the exclusion of the business, it ended up having a positive impact of BRL7 million in the EBITDA of CCL. But we believe because it was a negative impact, it should not be considered as an impact the same way you would consider the impact of selling -- actually selling the business by CAA.

Q - Felipe Hirai {BIO 15071781 <GO>}

Okay, Marcelo, so just to clarify that, the BRL92 million that you reported as the EBITDA of CCL includes the BRL7 million of gain from the sale of...

A - Marcelo Martins {BIO 16440115 <GO>}

Yes, it is.

Q - Felipe Hirai {BIO 15071781 <GO>}

...previous losses of the aviation business, and the 218 for the CAA includes the BRL93 million of gains from sales of the asset.

A - Marcelo Martins {BIO 16440115 <GO>}

Right. That's it.

Q - Felipe Hirai {BIO 15071781 <GO>}

Okay, good.

A - Marcelo Martins {BIO 16440115 <GO>}

Go ahead, Murilo.

A - Carlos Murilo Mello {BIO 16627976 <GO>}

Yes, Felipe -- sorry. Can you please repeat the difficult question regarding the hedging strategy and penetration?

Q - Felipe Hirai {BIO 15071781 <GO>}

Yes. I'd just like to understand better your hedging strategy. Actually, Murilo, when you comment -- when you made your comment, you said that you were quite confident on the outlook of sugar. But when we look into your hedge, (inaudible), I don't know if this is just -- if it is too simplistic just to measure one of the things that you are doing is that you are making more shorts on the -- on cost of sugar which is -- it doesn't make sense if you are more positive with the outlook of the commodity.

So if you could explain to us what is your hedging policy and what kind of the issuance that you are using, that will be pretty helpful.

A - Carlos Murilo Mello {BIO 16627976 <GO>}

Sure. Well, that's a very important question actually. Thank you. Actually one need to reason in terms of hedging combining both sugar hedging as well as the currency related, given we have revenues in dollar-denominated terms and cost in real-denominated terms. So first of all, we tend to have sort of a -- I'd like to say a conservative approach in terms of whenever we have decent margins, we try to lock them, of course, trying to balance with our own proprietary view on the sugar market and fundamentals for prices.

So that being said, the hedging that we have been doing so far is, given we were quite bullish on sugar prices since last year as I said, we were much on a lower pace comparatively to last year and to average years in the past. So that's what I mean by taking a fundamental view. But of course, we need to take a very responsible view over our business and trying to lock-in margins whenever they are decent or good should I say.

So you are right. We've sold -- we've written some call in the past as part of our hedging strategy. Those have been done in the past at prices which are lower than now, but combine it with foreign exchange hedging that have been done at rates considerably higher than they are now. So taking both the sugar and the FX hedges together, the margins at the time they were quite good.

What we have been doing in terms of selling cost specifically as we mentioned is that looking for next year, for example, we've been buying puts and we've been selling calls as part of our strategy, which is more bullish than just selling futures at the market prices.

Q - Felipe Hirai {BIO 15071781 <GO>}

If I could just ask another question, what is your current fee on sugar prices? Do you think that there could be some further upside from current levels?

A - Carlos Murilo Mello {BIO 16627976 <GO>}

Fundamentally speaking, we are still a little constructive on sugar, although we think that the bulk of increase has been done. As I also said, fundamentals have been recently -- very recently should I say improving both in Brazil and in India. Weather adverse happens, happening in Brazil and in India. So we believe those have been the justification for sugar prices going up recently. We can still see some further upside, but we think we are very fast approaching what we believe would be value for sugar.

Nonetheless, given increased risk aversion -- sorry, decreasing risk aversion worldwide and as commodities and equities, all assets in general going up, given that producers do not have the necessary lines of credit as they had in the past to hedge themselves, again, not applying on our specific case, and that consumers have been eating up buffer stocks and need to buy, we don't disregard spikes on sugar or overshoots on sugar prices, which not necessarily should be taken as fundamentally driven.

Q - Felipe Hirai {BIO 15071781 <GO>}

Okay. Thanks a lot for the answers.

A - Carlos Murilo Mello {BIO 16627976 <GO>}

You are welcome.

Operator

Your next question comes from the line of Paula Kovarsky from Itau Securities.

Q - Paula Kovarsky {BIO 15363001 <GO>}

Hi, everyone. It's Itau Securities. I have three questions for you. First question relates to the margins in the CCL business. If I understood correctly your explanation, Marcelo, on the BRL7 million, if I exclude those BRL7 million from the aviation business, the margin would have been 3.5%, so just to confirm that.

Then I would like to understand what's the impact of the consolidation of logistics and some of the trading activities that as far as I understood before were accounted for at CAA and now a part of the CCL's business in terms of logistics at least. So I would like to understand, how much of this fantastic margin comes from some migration from CAA's logistics business? Then, if -- also if part of this margin comes from the difference between the -- I mean, the misalignment between the reduction in ethanol prices at the sugar mill and maintenance of those prices at the retail station (to-date). So this is the first question.

Second question relates to ethanol prices. It appears to be kind of common among producers to have accelerated ethanol sales in this quarter. And I would like to confirm if the correct reading of this acceleration is that none of you is really convinced that ethanol prices will improve significantly going forward within this harvest?

And the third question is, if you could comment a little bit on the M&A activity here in Brazil and if any of the reason that movement has to do with any objectives that Cosan might have?

A - Marcelo Martins {BIO 16440115 <GO>}

Okay. Well, I'm going to answer the first question, but by the time I have finished my answer I will probably have forgotten the other two, but you'll remind me of them. The first one is BRL7 million, yes, I mean, if you exclude the BRL7 million, the margin would still be at 3.5%, you're right.

Second, as part of the EBITDA, we have synergies generated through the integration of companies, and most of these synergies they come from the logistics side of the business. We're talking about roughly BRL20 million of synergies in this quarter. It has to do with cabotage and the use of import terminals in Santos, for instance, when we imported diesel. So overall, a BRL20 million of an impact on -- during this quarter coming from the integration of both businesses.

And I'm sorry (inaudible). What was your other question related to this business?

Q - Paula Kovarsky {BIO 15363001 <GO>}

Yes, no. What I'm trying to understand actually is the sustainability of those fantastic margins going forward and how much of this comes from some sort of migration now that you've -- I mean, I'm assuming that before CAA already has, for example, gains from arbitrage between cabotage of ethanol going into the Northeast. So I'm just trying to understand what exactly is CCL and what exactly is some margins that is migrating from one Company to the other?

A - Marcelo Martins {BIO 16440115 <GO>}

Right. Okay. If you -- I'll try to give a very straightforward answer. We believe that the sustainable margin for this business is 3%. So the remainder, I think, there is a component of the aviation business of some gains related to the ethanol cost going down faster than the prices go down at the pump.

But as you know, ethanol is still not relevant in CCL's portfolio, but we have some gain coming from that as well and as you know, there is no transfer of margin between CCL and CAA. We don't sell ethanol to CCL. 100% of the ethanol bought in this quarter -- it's not 100%, maybe 95% was bought in the market and not from CAA.

Q - Paula Kovarsky {BIO 15363001 <GO>}

Okay.

A - Marcelo Martins {BIO 16440115 <GO>}

So we actually believe that the synergies and the gains -- the logistics gains are sustainable, and I think that in the next quarter we will have a better grip of what that number should be. This year we are working with roughly BRL50 million to BRL60 million out of which BRL20 million have already impacted the result in the First Quarter of the year.

Q - Paula Kovarsky {BIO 15363001 <GO>}

Okay.

A - Marcelo Martins {BIO 16440115 <GO>}

... the next session. You asked about the M&A, I got that one, but there was another one in the middle.

Q - Paula Kovarsky {BIO 15363001 <GO>}

The other one who was, I'm just trying to understand whether -- it appears to be a common strategy among you guys and the other producers to accelerate the sales of ethanol. I mean, does that mean you guys are not really bullish on ethanol prices recuperation or is there any other reason to do it?

A - Carlos Murilo Mello {BIO 16627976 <GO>}

Got it on all (press), we believe that we will have a recovery because the consumption in the internal market is very good. Deceleration in the beginning of the cost is because we had some -- not too likely, but we have some demand over that we predict before. So we take advantage of that selling more as of now that we predict before.

Q - Paula Kovarsky {BIO 15363001 <GO>}

Yes, but the margins weren't really attractive.

A - Marcelo Martins {BIO 16440115 <GO>}

No, that's right. The answer to your question is that our -- the profits of the ethanol price in the First Quarter were really bad. So we thought that prices would remain at a very low level and we decided to accelerate the sale because we didn't think we would make money, and then keeping ethanol in our inventory, and of course we wanted to reduce our working capital. That was the main purpose of accelerating the sale of the ethanol in the First Quarter. Therefore, we took that strategy.

But if you look at the prospect now considering what's going on with the sugar price, sugar production, we believe that the ethanol price will recover, and therefore, we predict better margins moving forward than we saw in the First Quarter.

Q - Paula Kovarsky {BIO 15363001 <GO>}

All right. Thank you. Then, I guess its M&A remaining.

A - Marcelo Martins {BIO 16440115 <GO>}

Okay. M&A, we always look at the opportunities, we see ourselves as a major consolidator in this business. It hasn't changed. We don't have the pressure to continue to buy assets, especially sugar and ethanol assets. We have a much more diverse portfolio today. And to be very straightforward with you, you know that there are companies that are up for sale today and the multiples these companies are being negotiated at, I mean, at least in this stage, are not attractive at all to us. So the multiples we're seeing today, I don't think we're going to buy any other sugar or ethanol company this year.

Q - Paula Kovarsky {BIO 15363001 <GO>}

Okay. Thank you, very much.

A - Marcelo Martins {BIO 16440115 <GO>}

Sure.

Operator

Your next question comes from the line of Tereza Mello from Citigroup.

Q - Tereza Mello {BIO 6448187 <GO>}

Hi. Good morning. A couple of questions. First, could you talk a little bit about volumes. I know that you provide guidance in your release about your volumes expectations, but if you had to think about what you were expecting at the beginning of the harvest and what you are expecting now after the rains in the lower -- the lower yields in the harvest, how much it would have decline both for sugar -- for crushed cane and sugar and ethanol?

A - Carlos Murilo Mello {BIO 16627976 <GO>}

It's very early to say something because we -- in the beginning of the crop, when you start in April, we could advance when you predict before. Of course, we lose some time in June, okay, or some time in July, but today we are very aligned with our budgets. Today, really we are keeping the same provision that we had before. It means 57 million tonnes -- 56 or 57 million tonnes of sugarcane crushed in our Company.

Q - Tereza Mello {BIO 6448187 <GO>}

Okay. And do you think the production of sugar and ethanol are the same or are they lower than what you had expected?

A - Carlos Murilo Mello {BIO 16627976 <GO>}

I might say to you it's very early to say that because if the weather becomes dry today...

Q - Tereza Mello {BIO 6448187 <GO>}

Okay.

A - Carlos Murilo Mello {BIO 16627976 <GO>}

...we can recover TSR or sugar content inside the sugarcane. Of course, at Central-South we lose some -- if you consider July, we lose some production of ethanol and sugar, but we can recover if the weather will be good from now on.

Q - Tereza Mello {BIO 6448187 <GO>}

Okay. Okay. Thank you very much. The other thing is has Jatai and Caarapo started yet?

A - Carlos Murilo Mello {BIO 16627976 <GO>}

No. Jatai will start at the end of this month and the Caarapo will start in September.

Q - Tereza Mello {BIO 6448187 <GO>}

Okay. And the other thing is talk -- good morning, what's the exposure to IP premium assets you have, could you remind me of that?

A - Marcelo Martins {BIO 16440115 <GO>}

Yes. Our total exposure to the IPI is what we have provisioned in our balance sheet, BRL270 million roughly. So it is 100% of what we have provisioned today. As you know, 275 -- BRL273 million.

Q - Tereza Mello {BIO 6448187 <GO>}

Okay. And you haven't made any (inaudible). If you have to disburse that, probably it's going to be over a long period of time but it would be the full amount.

A - Marcelo Martins {BIO 16440115 <GO>}

That's good, better.

Q - Tereza Mello {BIO 6448187 <GO>}

Okay. Thank you, very much.

A - Marcelo Martins {BIO 16440115 <GO>}

Sure.

Operator

Your next question comes from the line of Debbie Bobovnikova from JPMorgan.

Q - Debbie Bobovnikova {BIO 4684018 <GO>}

Hi, everyone. First, I would just like to congratulate you on the press release, definitely (five stars) in terms of transparency of information. So thank you for that. I just wanted to clarify if you -- the question that actually already came up in call, but number one thing is I really just want to understand the drivers behind your EBITDA and improvement in margins.

I guess, I'm really wondering because if you look at the details, especially in your sugar ethanol business, your realized prices actually declined and your unitary costs were flat to slightly up. So it seems like the real driver of EBITDA margin improvements were other higher -- other revenues probably from the energy business, maybe some reports. I'm wondering if any of that was also due to change in the provision accounting, is there any other issue?

So I'd just like you to kind of talk us through that, how much of the EBITDA margin improvement was really because the business improved and how much of it were extraordinary items that won't repeat again. Thanks.

A - Marcelo Martins {BIO 16440115 <GO>}

First, I think that if you look at the presentation, the EBITDA for the sugar business itself had a substantial increase, and it was not a function of other items, but the price of sugar and increase in the volume of sugar. You could ask me whether we have reached the peak of the price. Of course, not. I mean we haven't -- we've been under the average market price of sugar during that quarter for one simple reason. This is the function of our hedging strategy, what we're seeing now is the price of sugar we have hedged some months ago.

So that's why there is this lag between the price of sugar we're selling today and the market price, and it will continue to be like that up to a point when the curve will revert and the prices are going to start to go down, and -- however, the prices we're going to be (spending) will be higher than the market price. So with that, I would like to say that the best is still to come in a sense that the price would continue to go up and we will see that reflected in the results of the bid.

Other than that what we have is actually the sale of the aviation business, which had an impact on the EBITDA of the CAA business and not the CCL business as I explained to Felipe. And we also have, which is certainly part of the business from now on and will continue to increase, is the EBITDA coming from the co-generation business. It's pretty substantial in the First Quarter and it will continue to grow because we're making substantial investments in this business that we want a profit from that.

So I would like to say that in the First Quarter you are right in the sense that the price of sugar we're selling at is not actually -- the price doesn't reflect the price of sugar today, and second, the price of ethanol was much lower and the margin had a negative impact on the EBITDA of the combination of both sugar and ethanol. I don't know if I answered your question.

Q - Debbie Bobovnikova {BIO 4684018 <GO>}

Yes, that's great. On the hedging side, you talked a little bit about the fact that you probably are going to be expanding your hedges. Can you just take us through maybe, first of all, what have you done since the end of the quarter until today -- so for the past month and a half because prices definitely have rallied even in reais terms. So have you -- were you already able to close some of those hedges?

Then the second part of that is, can you just talk about your strategy, what is your target to hedge for this year in terms of as a percentage of your total volumes? I believe you mentioned somewhere around 5 million tonnes being the target for sugar for this fiscal year. So how much of that would you like to reach and how quickly will you be accelerating those hedges?

A - Carlos Murilo Mello {BIO 16627976 <GO>}

Yes, okay. Well, 5 million tonnes, I guess was the -- what was projecting for Indian imports if I'm not wrong. We are probably going to be exporting something like 3.5 million tonnes of sugar next year, probably 3.2 million tonnes with the current crop. Our policy here is, indeed, we've been lagging the pace of our hedging policies ever since last year as I said. Now, over the current -- over the last couple of months, we've been -- yes, profiting from very good sugar prices as we see them. We have been doing some hedges and we have intended to do those hedges on sort of options, strategy that assure a minimum price, but allow us to participate on upside sugar prices that have occurred, meaning they were very impulsive for the sugar business.

Now that sugar prices have improved considerably, we are considering to catch-up with the average pace of hedging that we have implemented in the past, obviously at much -- at considerably higher margin -- profit margins than we -- than what we would have achieved if the decision were to be taken six months ago.

Q - Debbie Bobovnikova {BIO 4684018 <GO>}

You can't really quantify any of that for us, can you?

A - Carlos Murilo Mello {BIO 16627976 <GO>}

Well, I can give you a guideline that we've been lagging. We've been going slower than usually, slower like than last year certainly and now we are continuing to catch up on the phase of our hedging given the very good margins that we're seeing now.

Q - Debbie Bobovnikova {BIO 4684018 <GO>}

Okay. So we should basically take last year as a base and just compare the two years?

A - Carlos Murilo Mello {BIO 16627976 <GO>}

That will be one way of seeing, yes.

Q - Debbie Bobovnikova {BIO 4684018 <GO>}

Okay. Great. Then one last question, just kind of assuming that all the key prices that you stay flat from here, the sugar price, ethanol price, the currency stays where it is, how should we think about the outlook for your cash flows through this year and also into 2011? Can you just walk us through that please, between all those stuffs, I know you have a lot of EBITDA coming but you also have still a lot of CapEx to be done, so if you can just walk us through that outlook, it would be great.

A - Marcelo Martins {BIO 16440115 <GO>}

When you say that the price of sugar and ethanol remains flat at where it is today, right? Okay. Well, as you can see by the average price of sugar we had in the First Quarter should increase substantially. In order to tell you the figures and I want to talk a little bit about the sugar and ethanol business separate from CCL because you know, the revenue is coming from CCL are much higher.

So I think it's fair to say that the gross margin in the sugar business should be over 40%. We hope that the gross margin in the ethanol business is not negative, if not positive of course. And, overall, I'd say, we should see the EBITDA margins as a combination of both at least in the 25% range. Hopefully, especially higher than that.

Q - Debbie Bobovnikova {BIO 4684018 <GO>}

Okay. Then can you just walk us through what your outlook is for your cash flows in terms of taken that outlook for EBITDA, but then also putting that together with your CapEx and your needs for working capital, how do you see the Company?

A - Marcelo Martins {BIO 16440115 <GO>}

Well, in terms of the CapEx, we have a substantial CapEx this year, especially as a result of investments in the co-generation business and it will continue to be relevant up until 2012, when if we finish the first phase of investment. Not to say that if we have another round of auction of energy sale at the price we've seen this first one, we would certainly be willing to continue invest in this business because it provides very good margins.

So I mean the amount of investments over the next couple of years would still be pretty substantial. And if you ask me a number, I would pretty much keep what we have for this year. I would say something in the range of BRL1 to BRL1.4 billion.

On the other hand the CCL business, there the CapEx is much lower and CCL has been a net cash generator over time. We're talking about the cash generation in the range of BRL200 million, this is what we have seen so far. If we increase the investments, it might go down a little bit, but will still continue to be an important cash generator for this business along with the co-gen business.

And what I would suggest is that as you model the Company to gain some additional information, I would suggest that you call Felipe Jansen, our Investor Relations to get some additional details.

Q - Debbie Bobovnikova {BIO 4684018 <GO>}

But in the end, do you think that you are going to be cash flow positive this year?

A - Marcelo Martins {BIO 16440115 <GO>}

Yes, we do.

Q - Debbie Bobovnikova {BIO 4684018 <GO>}

Okay. Thank you.

A - Marcelo Martins {BIO 16440115 <GO>}

Sure.

Operator

Your next question comes from the line of Matt Farwell from Imperial Capital.

Q - Matt Farwell {BIO 16404848 <GO>}

We've seen some fairly large moves in the world's sugar prices due to the short-term changes in weather patterns. I'm just wondering from a fundamental perspective, how do you -- how long do you think the sugar markets stay out of balance or do you feel any sense of urgency to lock-in high margins? I know you've stated that you're beginning to do so, but really at what point are you going to feel a strong sense of urgency to lock-in the high margin that we're seeing today?

I guess the second question that I have is that you've been discussing your net debt to trailing EBITDA of 2.98, is that a target that we should consider as optimal for the Company going forward? Then last the question is what drove the higher ethanol volumes in the quarter? I am seeing a pretty large jump.

A - Marcelo Martins {BIO 16440115 <GO>}

Well first, in terms of the -- let met start with the net debt-to-EBITDA. No, this is not the optimal net debt-to-EBITDA ratio. We'll like to go below that. So if you ask me what that number should be, okay between two and 2.5 times. While we continue to invest in the co-gen business, we're not going to get that even though depending on where the sugar prices are over the next quarter, I would say, I'm sorry, the next quarters.

That number would go down pretty substantially based on the better -- on a much better performance on the sugar price. But at the level we have today, we should continue to see the ratio around three times, even though it's not the optimal. The optimal price is going to be between two and 2.5 times. This is one answer. The other answer related to the hedging strategy, I will pass on to Murilo.

A - Carlos Murilo Mello {BIO 16627976 <GO>}

Yes. Well, the question is definitely -- no, we don't -- we're not sensing any sense of urgency, but we're rather taking a conservative approach that for locking-in margins that are really above average for the industry is very good. We see -- we think the upside on sugar prices, they do have some strong fundamentals.

And some domestic markets worldwide, like India, like Russia, China, Pakistan and others, they are catching up with New York prices which is a signal of consistency, meaning that domestic prices and domestic market, they are tight in sugar and the consumers domestically are paying higher prices in accordance to New York prices, which you get -- which gives us confident that we -- the sugar -- the recent sugar price up are justified by supply-demand.

Going forward, we see -- we tend to see sugar prices remaining strong as the supply-demand are tight going forward as well for next year.

A - Marcelo Martins {BIO 16440115 <GO>}

Then regarding the ethanol, the increase in the volume, I mean as I mentioned to Paula before we had anticipated prices to stay at this level, at a very low level. So we decided to reduce our working capital and then dump our inventories and that's why you saw much higher volume in the First Quarter.

Moving forward, we see prices recovering a little bit and then margins improving of course. And, therefore, the scenario changed pretty dramatically, especially because of the switch into sugar. So that's actually the reason why we sold more ethanol in the First Quarter. I am sorry -- I think we have to finish the call. We're about to start the call in Portuguese.

Marcus from Deutsche, I know you're waiting to ask a question. What I would like to suggest is that you join the other call and we'll give you a priority. You can ask the first question. For those of you who are in this call and who didn't have the change to ask -- to ask a question, I would suggest that you try to join the other call, even if you have need to ask a question in English, it's not a problem, well, we'll be glad to answer your questions.

Okay. So I just wanted to wrap it up to say that we had an outstanding quarter with a record income, the EBITDA is improving dramatically not only as the function of better industry fundamentals, but because of the combination we have in terms of our businesses in our portfolio.

As we have predicted, we think this is the right strategy. We're not going to destroy value for the business or the shareholders making acquisitions that don't make sense. We want to continue to grow the business in a very rationale way and we hope to be in a position to show even better results as we move forward.

Thank you, very much. We'll join the other call. Feel free to join us if you have questions left. Thank you. Bye.

Operator

This concludes today's conference call. You may now disconnect.