

Q1 2016 Earnings Call

Company Participants

- Mario Augusto da Silva, Chief Executive Officer
- Paula Kovarsky, Investor Relations Officer

Other Participants

- Alexandre Falcao, Analyst

Presentation

Operator

Good afternoon ladies and gentlemen. At this time, I would like to welcome everyone to Cosan SA First Quarter of 2016 Results Conference Call.

Today with us we have Mr. Mario Silva, CEO; Ms. Paula Kovarsky, IRO; Mr. Joao Arthur Souza, CFO; and Mr. Phillipe Casale, Investor Relations Manager of Cosan SA. 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 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 the slide show of this presentation are available through live webcast at ir.cosan.com.br. These 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'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 Ms. Paula. Ms. Paula, you may begin the call.

Paula Kovarsky {BIO 15363001 <GO>}

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Good morning everyone, and welcome to the Cosan SA first quarter 2016 teleconference. As announced on April 19 there were changes in the company's management structure, Nelson Gomes, who was CEO and IRO of Cosan SA step down to focus solely on his role as CEO and IRO of Comgas. Mario Augusto da Silva joined the Group as CEO of Cosan SA, and the IRO role was taken over by me, Paula Kovarsky in addition to my role as CZZ IRO. Besides me is Mario, Joao Arthur Souza, CFO and Phillipe Casale, IR Manager of Cosan SA are here with us for this conference call.

On slide number three, we outlined our business units for reference, and we can go straight to slide number four, where we present the results of Raizen Combustiveis, our fuels distribution joint venture, retail. Following the trend of previous quarters, our sales volume outgrew the market average, this growth reflects the maturation of a strategy implemented around three years ago, focused on the growth of the distribution network through the conversion of independent service stations mainly unbranded.

Sales volume in Otto cycle increased by 1%, compared to the first quarter of last year and this compares to a market contraction of 2% supported by the addition of 380 new stations to our network over the past 12 months.

Raizen's diesel sales grew 4% in the period as we added B2B contracts and due to the anticipation of the sugarcane crop, this compares to a decline of 6% of the market.

Adjusted EBITDA reached BRL590 million growing 7% versus the first quarter of 2015 and the first quarter of 2015 was positively affected by 35 billion worth of one-off impact, 46 million of diesel and gasoline price hikes and the negative impact of 11 million from asset divestments.

In the first quarter 2016, one-off totaled 11 million composed of a positive impact of 5 million from asset divestments and a negative impact of 16 million from expenses with internal restructuring. This quarter was also hit by the aviation segment due to lower sales volumes, lower oil prices and exchange variation, as well as by seasonal marketing expenses of 20 million. Note that those two are not included in the adjustments.

Moving to slide number five, let's talk about the sugar, ethanol, and cogeneration business of Raizen Energia. Starting with the first quarter, which corresponds to the last quarter of the '15-'16 crop year. The highlight of the quarter was the successful anticipation of crushing 2.8 million tons of sugarcane. This was an important achievement as we manage to anticipate the crushing in 13 out of 23 operating mills concluding the inter harvest maintenance in two months which is half of the usual time with no issues at the start-up of the operations in the mills.

The climate was up held of course, but the ability to anticipate the crushing is an example of the increased focus on the efficiency and cost. The EBITDA adjusted by biological assets and hedge accounting, in fact grew 38% over the same quarter of last season to 1.2 [ph] billion. The main factors supporting the EBITDA growth were 4% increase in sugar sales volume mainly supported by the largest -- the larger harvest and early crushing at higher prices, variation by the exchange rates, the anticipation alone represents BRL150

million, improved ethanol prices are actually slower drop in prices, which usually happens in March but slipper through to April, more than offsetting lower sales volume.

Unlike last year when sales were more concentrated in the last quarter of the crop year, which is the inventory carryover strategy. Ethanol sales this year were more evenly distributed between third and fourth quarters of this season.

In cogeneration increased the availability of biomass in the quarter of such a lower average prices reflecting a reduction in spot energy prices in Brazil.

At the end of quarter, we had 2.1 million tons of sugar from the '16-'17 crop year had BRL56.3 [ph] cent per pound and this is equivalent to almost all the volume of sugar to be exported and 669 million tons of sugar from the '17-'18 crop year had the BRL67.2 cent per pound.

Moving now to slide of six, where we provide a summary of Raizen '15-'16 crop year. We recently updated Raizen Energia guidance. The first hint we gave to the market in the beginning of the crop year, (inaudible) EBITDA ranging between BRL2.6 and BRL2.8 billion, we reviewed the range to 3 to 3.3 in the middle of the crop year and fine-tune the numbers to 3.2 to 3.4 more recently.

The guidance evolution follow the essential increase on average sugar and ethanol prices throughout the crop year. In fact, the sharp drop in ethanol prices in the beginning of the crop boosted demand in such a way that it's ended up quickly reducing forecasts for the inter-crop inventory and increasing prices well above expectations in the second half of the season.

Sugar sales prices increases to the valuation of the Brazilian real and then with successful anticipation of the crushing and the BRL115 million generated explains the gain over the last guidance review.

At the end of the '15-'16 crop season, adjusted EBITDA reached BRL3.5 billion, 25% above the result of the previous chart, mainly because of better sugar and ethanol prices in addition to the efficiency gains and cost control initiatives on top of the crushing anticipate. It is important to remember that in line with Raizen's hedging policy the positive impact of the real devaluation that favored EBITDA of sugar exports during the quarter and during the harvest has (inaudible) financial result.

Now talking more about our efficiency and cost control initiatives. We have been showing the evolution of cost regarding planting and treatment (inaudible) which is cutting, loading and transportation of the sugarcane and industrial cost. Now, we translate this impact more clearly into a result measuring differently. The cash cost of production increases 8% excluding the increase in CONSECANA, therefore lower than inflation in the period despite the lower amount of (inaudible) in sugarcane longer '15-'16 crop season and crushing anticipate.

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The CapEx was 24% lower compared to the '14-'15 crop and within the guidance reflecting lower investments in sugarcane renewal and the conclusion of expansion project.

And the OpEx, which is essentially the sum of maintenance CapEx and OpEx has a reduction of about BRL26 million in nominal terms are almost 115 million, if you look at the comparison in real terms.

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Turning now to Comgas on slide seven. This is our natural gas distributions in the State of Sao Paulo, Cosan Comgas reported its results on May, 10. The main highlights of this quarter was the growth on the residential volume, this segment was negatively affected by the hydro crisis in the State of Sao Paulo. Water shortage came to an end and most importantly, the State were drooping census to reduce consumption, which led to a reduction in the per capita consumption of gas.

(inaudible) represents some 60% of gas consumption in residential seg. The recovery (inaudible) coupled with the connection of 115,000 new clients over the last 12 months resulted in a 23% growth in sales compared to the first quarter of 2015. The commercial segment also grew 8% as we connected the (inaudible) client over the last 12 months.

The industrial factor in seg continues to suffer on the decline of industrial fees falling 12% compared to the first quarter of 2015 but we had some specific events that to explain the greater contraction compared to GDP. The migration of the textile industry to biomass, the decline of consumption in steel plant following the sharp drop in construction and automakers activity. Comgas continues to work on new customers, connection and new applications for this segment but the macro scenario remains a main driver here.

The normalized EBITDA rose 8% compared to the first quarter of 2016 on improved sales mix and tariff adjustment. The IFRS figures doubled compared to the same period last year due to the sharp reduction in the cost of gas and consequently the recovery of BRL195 million of the regulatory current account contributing to higher cash generation. Just to remember, the current account is a clearing account between Comgas and the regulator regarding the difference between the price paid for the gas and the price of gas imbedded in the calculation of the tariff.

The balance is adjusted by the Selic rate and amortized it annually to an adjustment in the tariff or down depending on whether the balance is negative or positive for the company. In other words, the gas is essentially a pass-through and this is why we report and focus our discussion on the company's normalized EBITDA. And as mentioned the drop in gas purchase price accelerated the amortization of the current account, which is now positive, positive that is in favor of the consumer. Comgas invested BRL94 million in the quarter of which 75% of network expansion, 268 kilometers and 72,000 new customer.

Let's go to slide 10. Starting with lubricant, which includes the operation in Brazil, Paraguay, Uruguay and Bolivia besides England and now Spain. Volumes increased 8% compared to the first quarter of last year mainly in finished lubricants in Brazil.

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Speaking about Brazil, the market fell 9% between periods because all the lubricant has been gaining major account, especially automakers which means that vehicles, lead manufacturers with mobile lubricant and the recommendations to use the product later on. Today we have 48% market share in light vehicles, 39% market share for trucks and 89% for motorcycle.

The EBITDA rose 10% compared to the first quarter of last year reflecting the drop in sales volume, better product mix and international operation results translated into the Brazilian real. About Radar, EBITDA declined with lack of property sales in the period and no change in market indexes used to derive the FMV, the fair market value of the portfolio, both are non-cash effects.

Speaking about the corporate, general and administrative expenses totaled BRL42 million in the quarter impacted by higher personnel and consulting expenses as well as inflation in the period. The line other expenses decreased once -- the last year's figure was negatively affected by expenses related to the merger of Rumo-ALL.

Moving to a slide nine, where we present Cosan SA's consolidated results on a pro forma basis considering 50% stake in Raizen. The adjusted EBITDA grew 15% year-on-year and reached BRL1.2 billion in the first quarter of 2016 mainly on Raizen Energia's positive outlook. We reversed the BRL44 million loss in the first quarter of last year to 249 million net income in the first quarter of 2016, as a result of Raizen Energia's operational improvement and the recovery of the regulatory current account.

Which offset the increase in financial expenses, which grew due to the higher interest rate and the fair value loss non-cash impact of a put option of two Rumo shareholders invited to a right to convert their Rumo shares into season free shares in accordance with the material fact dated April 28, 2016. The pro forma free cash flow for the equity was BRL609 million again reflecting the operational performance. Comgas regulatory current account recovery, lower CapEx and deleveraging.

The difference between the first quarter of 2015 free cash flow for the equity and this quarter's figures reflects two main effects, roughly 50-50. Lower cash generation from Raizen Energia, remember that last year the strategy of sharing ethanol inventory was more concentrated in the last quarter of the crop year partially offset by the Comgas current account effect and higher amortization of (inaudible). The pro forma CapEx fell 12% to 1 billion in line with the play.

We can move to slide number 10, we had a significant reduction in leverage this year. Net debt EBITDA fell from 2.5 times at the close of the fourth quarter of 2015 to 2.1 times at the end of the first quarter of 2016 due to a 14% increase in the Last 12 months EBITDA and the 3% reduction in net debt.

With a 4% decrease in gross debt due to the amortization of approximately BRL800 million worth of debt in Raizen, which is the Senior Notes 17 and lower cash flow. The average debt cost on a pro forma basis do not change remaining a 93% of the CDI. We

announced yesterday 290 million worth of dividend payment totaling \$0.71 per share. The record date is May 15, and shares will trade ex-dividend on May, 16.

If we adjust for this payment net debt to EBITDA would be 2.2 times. Our goal is to continue to leverage for the medium, long-term, we believe to find the comfortable level, appropriate the portfolio of assets that we have. In the next two quarters however, we will probably see an increase in this ratio due to high (inaudible) working capital cycle seasonality decreasing towards the end of this year and beginning of next year when we finish the '16-'17 crop year.

Let's go to slide 11, the last slide of the presentation to talk about guidance. There was no change to the guidance presented last quarter yet Raizen's numbers were preliminary at the time, as planning and budgeting cycle follows the crop year. Specifically on Raizen Energia, the guidance indicates the crushing of 60 to 64 million tons of sugarcane and an EBTIDA ranging between BRL3.3 and BRL3.6 billion (inaudible) compared to the 3.5 billion adjusted EBITDA of the '15-'16 crop year, despite the increase in sugar price.

A few points to consider here. As we said the anticipation of the crushing generated on the EBITDA of approximately 115 million that increase EBITDA of last year crop. In the '16-'17 we had sugar sales with an exchange rate of about 2.9 reias per dollar and the effective exchange rate when we ship the product was high. As I mentioned in the previous slide, the shipment exchange rate affect EBITDA while the exchange rate is fixed to financial instrument is a real plus proxy of the economic impact or the cash generation of Raizen Energia.

The '16-'17 crop guidance assumed a real to the dollar of approximately 4 and this exchange rate mostly established through financial instrument guarantees the economic or the cash result of Raizen Energia. But the EBITDA at the end of the day reflects the effect with exchange rate at the time of the sugar shipment.

If you look at the current exchange rate, we would have downside to the EBITDA metrics but no impact to the estimated cash generation. Our decision for now is not to change the guidance as we are in the very beginning of the season and we cannot ignore not only the volatility of the uncertainty on the exchange rate, but also the climate issue. Climate conditions were favorable in the previous crop year and we still don't know whether the situation will be exactly the same.

This concludes our presentation today. And I'd like to open to the Q&A session.

Questions And Answers

Operator

Thank you. We'll now begin the question-and-answer session for investors and analysts. (Operator Instruction) Our first question comes from Alexandre Falcao with HSBC.

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Q - Alexandre Falcao {BIO 5515455 <GO>}

Hi. Actually I have two questions. The first one is regarding your debt planning. Since we are seeing a huge move on the long-term interest rates, a downtrend and the fact that you guys are levered and less than efficient on the cost of financing.

Is there any plans to take advantage of this and go back to the market and maybe try to redeem some of their more expensive debt? That is the first question.

And the second question is, do you have -- hoping Zometo [ph] on the news today talking about looking at the infrastructure projects. I just wanted to know if that is going to be done in the CZZ level or in the Cosan level. And which would be those infrastructure projects that you guys would be interested in? Thank you.

A - Mario Augusto da Silva {BIO 18087499 <GO>}

Hi, Alexandre. This is Mario speaking. Yeah, you are right in terms of the market as a consequence of the change in government, the market has been improving for the Brazilian corporate, on the debt side we've been following and actually our bonds, they have been trading especially well in the past week and for sure will be following the market.

And in general we are always looking to opportunities in the debt to capital markets. At this moment there is nothing concrete that we are looking but we've been following the dynamics of the market to see if any point make sense given the debt profile that we have. Just remember we have the BRL bond maturing in 2018 we have a US dollar bond maturing in 2023 and we have the (inaudible). So we keep looking and telling the market to see if a good opportunity might show up in the coming weeks.

But the answer at this moment, there is nothing concrete and but we will keep telling the market. It's very recent, the improvement in the market. So probably we will have to wait a couple of weeks more or at least a couple of months more to see if that train regarding the Brazilian corporates will remain.

I will pass to Paula.

Q - Alexandre Falcao {BIO 5515455 <GO>}

And just on that -- a quick follow up on that. The first one would be the debt in the Comgas level that you guys were planning to do and of course the market did not allow it. Is that the -- sort of the, if those conditions are confirmed, could we assume that -- that's going to be the first move that you guys are going to do? Thank you

A - Mario Augusto da Silva {BIO 18087499 <GO>}

That was the -- in the last time that Cosan went to the market that was the idea, but again, there is nothing concrete but we can talk about right now. For sure, one of our priorities to try to improve the tax efficiency, because I mean in terms of where the debt is located at this point is not the ideal vehicle, we know that and we keep looking for alternatives and

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opportunities to improve that efficient. But I mean, so our -- we don't have nothing concrete, but last time that we went to the market the idea was to -- the new bond would go together to the gas division, but again right now, we're still looking to the market and look for the dynamic. As soon as we have anything concrete we will come back to the market. Okay.

Q - Alexandre Falcao {BIO 5515455 <GO>}

Thank you.

A - Mario Augusto da Silva {BIO 18087499 <GO>}

Paula.

A - Paula Kovarsky {BIO 15363001 <GO>}

Okay. Talking about the possible investment and infrastructure, I mean there is nothing that we can say other than this is an active growth and we are always looking at good opportunities and we only move into the opportunities that they make strategic sense and if they use the required returns. And also if they fit into this market plans that we've been talking about which is deleveraging the company, adjusting the corporate structure and so on and so forth. So there is nothing specific that I can say.

In terms of the investment fit, again contractually speaking, we have the operating companies in the field distribution, in sugar, methanol and gas distribution. So essentially whenever the investment has to do with the business in which the operating company is participating then it makes sense to do downstairs whenever, it's a brand new story or completely a new business development then we probably will be (inaudible) but that's as much as I can say for now. Okay.

Q - Alexandre Falcao {BIO 5515455 <GO>}

Okay, perfect. Thank you.

Operator

(Operator Instructions) This concludes today's question-and-answer session. I'd like to invite Ms. Paula Kovarsky for her final consideration.

A - Paula Kovarsky {BIO 15363001 <GO>}

So, thanks again for attending the conference call. We'll see you next quarter. Have a nice weekend.

Operator

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

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