

Cosan Day 2023: The Anatomy of a Well-Conducted Orchestra

Ticker: CSAN3 BZ | **Target Price:** 27.00 (BRL) | **Rating:** OUTPERFORM

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Today Cosan held its 2023 Investor Day to discuss strategy updates with the market. Overall, we came away with the impression that Cosan's orchestra continues to be very well conducted under the leadership of Luiz Henrique Guimarães (CEO) and Marcelo Martins (Cosan Group's VP of Strategy), and all the group's executives. The symphony continues to be playing in harmony with the company clearly focused on unlocking Brazil's potential in key areas, such as agribusiness, clean energy, logistics, and minerals.

Cosan Investimentos is carefully conducting the orchestra. At this stage, it appears clear to the market that Cosan (OP, R\$27TP) has become a solid capital allocator with a profound knowledge of its entire range of business lines, offering investors a unique investment proposition. Indeed, in our view, Cosan investimentos leads this delicate, well-balanced symphony. Once again, Marcelo Martins reinforced that buybacks at the holding group level will always be a priority; however, this will be done without interfering in decisions about allocating capital to good projects (in fact, these are typically actively discussed between the holding group and subsidiaries). Moreover, management added that keeping a solid financial position at the holding group level (without exceeding leverage at above 2.5x) would also continue to be a priority. The holding group focused on showing how its dividend stream, which was previously highly concentrated in Compass and Raízen, is now more appropriately balanced between the different businesses (Figure 1), having access to various geographical markets that provide a solid revenue stream in USD (Figure 2). Management said that the timing of the next businesses to be potentially listed (Moove and Compass) will be carefully chosen, and this is likely to happen in 2024, while the holding group will continue to push its subsidiaries to sell stakes in assets that could also generate positive liquidity and secure better prices for assets (without hurting decisions on capital allocation).

Compass is the "strings" section. The strings (violins, cellos, basses, piano, and harps) are known to be the most important section of an orchestra, and has the most musicians. Right now, we attribute this role to Compass, which, in our view, should deliver the most exciting upcoming news flow and could offer the most near-term growth. With the company potentially going public in 2024, Compass will begin to reap the benefits from a long investment cycle. By the end of 2023, the company will cash-in on the sale of five gas distribution companies in the Northeast of Brazil (as required by Brazil's antitrust authorities after acquiring Gaspetro), generating liquidity that will help the company to focus its efforts on the more representative markets in the Center/Southeast of Brazil. The growth potential of these gas distribution companies, together with Comgas, is significant (as shown in Figure 3), as Brazil has a very low level of penetration in terms of natural gas. In addition, management explained that another key event will be the start-up of the Santos re-gasification facility in October 2023. The facility has the capacity to regas ~14mn m³/day (out of Brazil's total gas demand of ~80mn m³/day), and it should quickly ramp up 3mn m³/day based on the supply contract with Comgas. Furthermore, another 3mn m³/day should gradually ramp up based on supplying the B2B LNG business (off-grid and distributed by trucks), where the terminal is expected to grab market share from LPG, diesel, and fuel oil in a radius of 1,000-1,200kmns. Management noted that other sources of growth for Compass could be through exercising its right of first refusal to purchase the stake from state governments within its gas distribution companies as well as by growing biomethane supplies via its partnership with Orizon, where Compass has the right to treat and off-take up to 100% of the biomethane coming from Orizon's landfills. Comgas's tariff revision will likely be kick started in 3Q24.

Moove and Cosan Terras are the "woodwind" section. The woodwind section is a smaller but an equally important part of the orchestra (flute, oboe, clarinet, and bassoon). Moove began life as very small, but recently entered into the club of companies that generate EBITDA in the billion range. The lubricant assets were acquired back in 2010 from Exxon, with negative EBITDA results at that time, but it has grown both organically and through acquisitions (the most recent acquisition in the US was in partnership with Exxon). Management noted that the company's strategy for now will be to continue growing by grabbing market share (20% in Brazil, 3% in the US, 5% in the UK, 8% in both Paraguay and Bolivia) and it is also a potential candidate to carry out an IPO in 2024. Meanwhile, although "small," Cosan Terra (a land company owned by the group) has already reached an estimated ~R\$14bn in land value, and could grow significantly in the future by monetizing carbon credits both in voluntary and regulated markets. Management highlighted it has been closely studying reforestation and the risks involved, and the decision to delve further into this business will ultimately depend upon how to mitigate these risks together with the benefits brought by carbon prices.

Raízen is the "percussion" section. Drums are the oldest instruments known to man, and Raízen is Cosan's oldest business. Old, however, does not mean it is less exciting. Raízen will begin operating its first e2g (second generation) ethanol plant on

September 28, 2023, with 82mn liters of capacity and it will ramp up to ~R\$250mn-R\$300mn in annual EBITDA. We recall that the company has already contracted volumes (based on fixed prices) for a total of 8 plants that will ramp up by 2026, and management wants to reach a total of 20 plants by the 2030/31 crop year (1.6 bn liters, with a potential of R\$5bn-6bn on the bottom line). In terms of fuel distribution, management also sees the scenario improving during 2H23 (as discussed in our [report](#)), with more cost-cutting opportunities ahead.

Rumo and VALE are the “brass” section. This is where the big sound of the orchestra comes from and this section is almost always called in at the climax of performances (trumpets, trombones, tuba, French horns, cymbals, etc.). Nonetheless, a big finale usually takes time to appear in symphonies. In our view, Rumo and VALE's could be Cosan's big finales given the significant potential value creation in the long term. For VALE, little detail has been provided other than CEO Luiz Henrique Guimarães (and VALE's chairman) has been reiterating that Cosan's ideas are being positively received by the company. Over the long term, perhaps the ultimate value creation for VALE could be a listing of the base metals business. For Rumo, basically the company should continue to be focused on expanding operations in Malha Paulista, Malha Central and Phase I of the Lucas do Rio Verde rail network, which should make up a big chunk of Cosan's long-term growth (please see more details in a report by our transportation team [report](#)).

Our take: All in all, Cosan continues to look like a well-orchestrated group with top-quality executives who are closely tied to long-term objectives through the company's stock remuneration plan. As we recently highlighted in our Charts of the Week ([What is Value, What is Growth and What is Both in Latam Oils](#)), we see Cosan as being more of a growth play. However, with solid value and good dividend yields, we are maintaining our Outperform rating.

Figure 1 - Dividends and Interest on Equity Received by Cosan - more balanced amongst subsidiaries



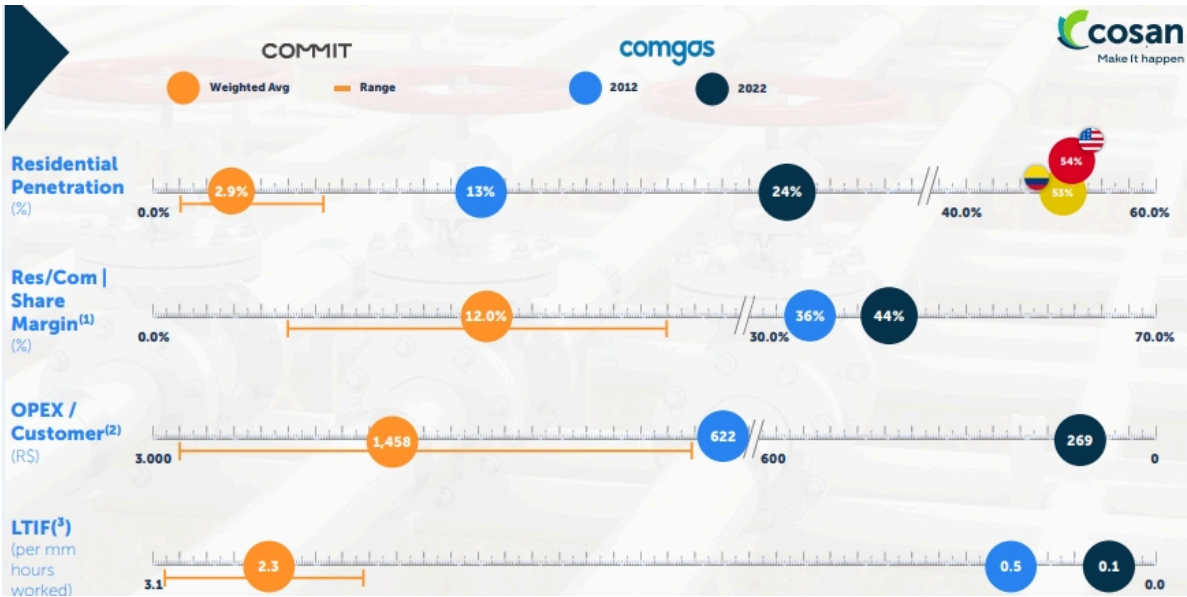
Source: Company

Figure 2 - Presence in areas where Brazil has a clear competitive and comparative advantage with exposure to strong currencies

	raízen	rumo	COMPASS	m00ve	Land (1)	VALE
Regions with highest potential in Brazil						
Exposure to Brazilian demand						
Exposure to global demand						
Hard currency						
Sustainable development / decarbonization						

Source: Company

Figure 3 - Strong growth potential in gas distribution



Source: Company

Figure 4 - Cosan's Financials

Cosan Income Statement, R\$mn	2022A	2023E	2024E	2025E
Net revenues	162,253	147,990	155,346	154,970
(-) COGS	-147,951	-130,833	-135,830	-133,176
Gross profit	14,302	17,156	19,516	21,794
<i>Gross margin (%)</i>	<i>9%</i>	<i>12%</i>	<i>13%</i>	<i>14%</i>
SG&A, Others	-5,145	-1,843	-2,139	-2,352
(-) Selling	-3,850	-2,040	-2,265	-2,439
(-) G&A	-3,189	-1,504	-1,553	-1,604
(-) Others	1,894	1,701	1,679	1,691
EBIT	9,157	15,313	17,376	19,442
<i>EBIT margin (%)</i>	<i>6%</i>	<i>10%</i>	<i>11%</i>	<i>13%</i>
Net Financial Results, Others	-6,860	-7,474	-6,295	-5,354
Equity Pick-up	350	50	50	50
Financial Expense	-10,084	-9,244	-7,220	-6,067
Financial Revenue	5,446	1,670	825	613
Exchange Rate Variation	-1,848	50	50	50
Derivatives	-725	0	0	0
EBT	2,296	7,839	11,081	14,087
(-) Tax	551	-2,665	-3,768	-4,790
(-) Minority interest	-1,671	-1,347	-1,905	-2,330
Net income	1,176	3,827	5,409	6,968
<i>Net Income margin (%)</i>	<i>1%</i>	<i>3%</i>	<i>3%</i>	<i>4%</i>
Number of shares (mm)	1,874	1,874	1,874	1,874
EPS (R\$)	0.63	2.04	2.89	3.72
DPS (R\$)	0.00	1.02	1.44	1.86
D&A	8,013	6,334	6,937	7,437
EBITDA	17,170	17,901	20,500	23,011
EBITDA (Proportional for Cosan)	14,027	13,019	14,493	16,044
Raízen Fuels (44%)	4,371	1,244	1,373	1,487
Raízen Energia (44%)	4,038	5,197	5,787	6,711
Raízen Argentina (44%)	744	764	830	876
Comgás (88%)	3,045	3,462	3,699	3,789
Moove (70%)	596	656	710	768
Rumo (30%)	1,233	1,695	2,094	2,413
Reported EBITDA	15,762	17,150	18,995	21,326
<i>EBITDA margin (%)</i>	<i>9.7%</i>	<i>11.6%</i>	<i>12.2%</i>	<i>13.8%</i>
<i>EBITDA growth yoy(%)</i>	<i>36.3%</i>	<i>8.8%</i>	<i>10.8%</i>	<i>12.3%</i>
Raízen Fuels's Adj. EBITDA	2,662	2,827	3,120	3,381
<i>EBITDA/m³</i>	<i>96</i>	<i>100</i>	<i>108</i>	<i>115</i>
<i>EBITDA growth yoy (%)</i>	<i>-10.3%</i>	<i>6.2%</i>	<i>10.4%</i>	<i>8.3%</i>

Free Cash Flow, R\$mn	2022A	2023E	2024E	2025E
= Adjusted EBITDA	15,762	17,150	18,995	21,326
(+/-) WC Change	-1,102	-1,070	-359	-243
(+/-) Capex/Divestments	-8,241	-13,188	-11,998	-12,368
(+/-) Net Financial Results	-4,638	-7,574	-6,395	-5,454
(-) Income Tax	551	-2,665	-3,768	-4,790
= FCF	2,332	-7,346	-3,524	-1,529

Financial Ratios, Leverage	2022A	2023E	2024E	2025E
EV/EBITDA	7.2x	6.3x	5.7x	5.2x
P/E	30.1x	9.2x	6.5x	5.1x
P/B	1.7x	1.5x	1.4x	1.2x
FCF yield (%)	6.6%	-20.8%	-10.0%	-4.3%
Div. yield (%)	0.0%	5.4%	7.6%	9.8%
Net Debt/Adj. EBITDA	3.4x	3.4x	3.1x	2.7x
D/E (Gearing)	262%	255%	228%	195%
ROIC (%)	9.9%	14.7%	15.6%	16.3%
WACC (%)	12.5%	11.8%	10.8%	10.4%

Source: Bradesco BBI

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