

Cosan Limited (NYSE:[CZZ](#))

Q1 2017 Earnings Conference Call

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Executives

Mario da Silva - Chief Executive Officer

Paula Kovarsky - Investor Relations Officer

Joao Arthur Souza - Chief Financial Officer

Phillipe Casale - Investor Relations Manager

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to Cosan SA's First Quarter of 2017 Results Conference Call. Today with us we have Mr. Mario da Silva, CEO; Mrs. 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. [Operator Instructions] The audio and slideshow of this presentation is 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 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 will turn the conference over to Ms. Kovarsky. Ms. Kovarsky, you may begin your presentation.

Paula Kovarsky

Good morning, everyone. Welcome to Cosan SA's first quarter 2017 results conference call. As usual, let's start the presentation by talking about its business line and then consolidate its results. So, we can go straight to Slide #4 to talk about Raizen Combustiveis. 2017 started with a few signs of deceleration of the downward trend in fuel consumption same in the past few years in Brazil. The comparison base is few weeks, but the volume in gasoline equivalent, for example, and this is where we adjust ethanol for its energy efficiency. Closed the quarter with a 1% growth year-on-year and total volume sold decreased only 1% this quarter and this compares to a market that shrank 5% in 2016 compared to 2015. All those numbers are based on the ANP data.

A quick recap of our strategy. Over the last 4 years, we focused on the expansion of our network through the conversion of new stations and equally important the renewal of existing contracts privileging a long-term partnership with our dealers. In the meantime, we invested to increase the logistics efficiency when supply in our growing network in a changing environment and once again, Raizen outperformed the market. We call this consistency.

Let's look at the numbers. Raizen Otto-cycle sales grew 3% in the first quarter of 2017 versus '16, while the ANP figures remain virtually flat. Diesel sales remain affected by slow industrial activity in the country. The total volumes sold dropped at 6.1% according to Sindicom and ANP respectively. But despite the lower demand during the intercrop period, Raizen sales grew 3% due to new contracts on energy and mining industries. Aviation volumes were hit again by lower demand for air transportation. The number of departures fell 7% year-on-year this quarter according to ANAC data.

The results. First quarter '17 adjusted EBITDA grew 16% in comparison to the same period last year reaching BRL682 million. We had a better sales mix with more gasoline, but the main contribution here came from the supply and commercialization strategies as well as cost reduction and efficiency. I have been repeating myself, but I would just like to remind you that this strategy goes well beyond the imports. We are talking about inventories management, logistics optimization, trading so on and so forth.

For the coming quarter, we foresee a low to mid-single-digit expansion of the EBITDA and the range will very much depend on prices volatility and the evolution of demand until the end of the quarter. Adjusted EBIT grew 27% this quarter outperforming adjusted EBITDA expansion. We reiterate our view that EBIT better reflects business performance compared to EBITDA being a better proxy of our search for efficiency, while reducing invested capital. We actually measure our performance internally based on returns. Raizen Combustiveis CapEx totaled BRL212 million comprising investments and infrastructure, expansion of the network through the conversion of new stations and the renewal of existing contracts. We closed the quarter with a total of 6,043 Shell branded stations implying a net addition of 134 stations over the last 12 months and 16 in the quarter.

A quick reconciliation with CapEx here. The conversion pace was a little slower this quarter indeed, but CapEx was relatively high, because in fact because of some CapEx that slipped from the last quarter of last year. Remember, we said we were expecting CapEx to reach the high end of the guidance in 2016 and we ended up in the middle. So, the difference is the CapEx that slipped to this quarter and anyway there is no change to guidance neither for CapEx or conversion targets for 2017.

Going to Slide 5, this quarter concludes the 2016/17 crop year. We will therefore discuss both quarter and crop year results in the next couple of slides. Crushing, this season, was 5% smaller compared to the '15/16 crop year reaching 59.4 million tons. Just as a reminder, we started earlier last year crossing nearly 3 million tons of cane still in March and that volume was therefore accounted for in the '15/16 crop year. And following up on what we

said throughout the year, weather was drier than last seasons benefiting crushing, but taking it to own the sugarcane growth. TCH at the end of the '16/17 crop year was of 80 kilograms per ton and average TRS 129 kilograms per ton. Combining both indicators, the TRS per hectare reached 10.3 tons of TRS per hectare in the '16/17 crop year versus the 11.4 in the '15/16.

Regarding the sales of each product, sugar sales fell 28% this quarter in line with the commercialization strategy of anticipation anticipating on product sales as defined early in the year as the total volumes sold in the crop year dropped 9% affected by lower resale volumes. Average sugar prices were higher for both quarter and crop year growing about 7% in comparison to the same period of last year. Ethanol sales were 20% lower this quarter due to different seasonality as well, but flat comparing full crop year. Average sales price fell 10% in comparison to the first quarter of 2016 due to higher supply availability, but remained virtually flat on year average comparison at around BRL1.7 per liter. Cogeneration, production and sales of energy shrank 24% in the quarter due to lower biomass availability. Remember, again we were already crushing this time last year and the yearly reduction was 2% while the average energy price sold was BRL185 per megawatt hour.

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

Looking at the 2016/17 adjusted EBITDA, it reached BRL3.1 billion, 11% lower than last crop. In both cases EBITDA drop can be explained by the exchange rate effect in sugar revenues. This accounting in fact is essentially the difference between currency hedge and actual exchange rate when we effectively shipped the sugar accounted below the EBITDA line. Just for you to have a sense, hedged exchange rate for the first quarter of 2017 was BRL3.73 to \$1 on average, while the average shipping exchange rate was BRL3.12. The hedge gain was therefore BRL174 million this quarter. And when we look at the full crop year the effect is BRL602 million. So if we were to include the currency hedge effect from sugar exports back into the adjusted EBITDA, we would have reached BRL3.7 billion this year versus BRL3 billion in the '15/16 crop year on a comparable basis implying a 25% growth. The EBIT per TRS fell 38% this quarter reflecting the same negative impact of exchange above the line and higher CONSECANA costs divided by lower volume. For 2016/17 average EBIT per TRS reached BRL180 per ton.

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

total amount of sugar to be exported. The main reason behind such decision was the recent melt down of sugar prices in our view the '17/18 crop season will likely be more balanced. We will have a more balanced global supply and demand equation, but that being said we no structured reason for such [indiscernible] in sugar prices. It actually feels like this is our view, I mean remember when prices were going up like there is no tomorrow last year, despite the big long position of the funds and we know how to part in the physical market.

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

Building the topic and highlighting the ongoing efficiency increase and cost reduction journey of Raízen Energia, the unit cash cost of production is sugar equivalent excluding the impact of CONSECANA as well contracted 5% in the first quarter of 2016 and 2% in the crop year more than absorbing inflation in our own production of sugarcane. And last but not least, CapEx, we spend BRL897 million this quarter, 11% or more than we did in the first quarter of 2016 and BRL2.1 billion in the '16/17 crop year within the guidance. The yearly increase reflects higher renewal of the sugarcane fields to 15%, I mentioned that already. We believe this to be the adequate level for the next few years in terms of sugarcane field renewals as well as the anticipation of a few mandatory expenses regarding health, safety and environment.

Turning now to Comgás on Slide 7 and since Comgás reported their results this month; let's focus on the highlights only. The first month of the year brought a slight recovery of industrial sales volumes, the comparison base as weak as well, but we had once again an increase in demand from a few clients in segments such as ceramics, chemical and automotive resulting in a 3% growth versus the first quarter of '16. Residential and commercial segments kept on growing year-on-year 1% and 5% respectively due to the connection of new clients. The residential growth however was negatively affected by warmer weather reducing a bit the unit consumption. The total volume sold by Comgás excluding thermal generation grew 2.5% in the first quarter of '17 compared to '16.

Comgás' normalized EBITDA grew 19% this quarter and reached BRL384 million reflecting the higher volumes sold and inflation adjustment on margins adjusted by the regulator back in May 2016. I would like to remind you that tariff review adjustments include the annual adjustment of inflation on margins as well as the pass-through of gas costs as provided for by the concession cost. IFRS EBITDA fell 40% this quarter due to drop in the cost of gas and consequent BRL60 million reduction of the regulatory current account with

balance stands at BRL354 million in favor of consumers. The base of current accounts reduction going forward will very much depend on the exchange rate and the evolution of gas prices as well as on the parameters for reduction to be defined by the end of May as part of the annual tariff anniversary. Comgás closed the first quarter of '17 investing BRL75 million, 20% less compared to the same period last year, but in line with the strategy of higher investments in – on the next quarters.

Let's go to Slide 8, about Moove, the Brazilian markets for lubricants still show signs of contraction on lower economic activity, but Moove kept on outperforming the market expanding in domestic operations by 1% this quarter versus 1% drop of the market considering SINDICOM data. International operations maintained an average growth of 7% of volumes. So Moove's EBITDA reached BRL43 million and the growth was supported by increasing share of [indiscernible] factory fuel in Brazil and higher volume in international operations. Now, on corporate, general and administrative expenses reached BRL40 million, 5% below the same period of last year and the slide encompasses personnel as well as legal and consulting services.

Moving to Slide 9, where we present the consolidated results of Cosan S/A on a pro forma basis, i.e. considering 50% of Raízen results. The improvement of production and performance of Raízen Combustíveis, Comgás and Moove was offset by lower results from Raízen Energia with the negative impact – negative accounting affects already explained resulting in a 4% drop of Cosan's adjusted EBITDA that reached BRL1.1 billion. If we were to include the positive – the hedging gains on FX for sure exports on top of the adjusted – on top of adjusting for non-recurring effect also detailed in our earnings release, Cosan's EBITDA would have been BRL1.2 billion this quarter calling for 8% growth in the same comparison basis versus last year. IFRS EBITDA for the first quarter of '17 with no adjustments was BRL974 million. Cosan net income reached BRL205 million this quarter versus BRL247 million in the same period last year. Pro forma CapEx grew 5% this quarter reaching BRL631 million due to higher expenditure in Raízen partially offset by a reduction at Comgás. The pro forma free cash flow to the equity reached BRL139 million and I will dig into that number in the next slide.

So let's go to Slide #10 and let me first talk about the pro forma net debt evolution that once again decreased income cash tax to the previous quarter reaching BRL7.6 billion. We have reduced the company's leverage to 2x net debt to pro forma EBITDA which considers you can see there is normalized EBITDA for Comgás and the reported net debt to pro forma EBITDA fell below 2x as indicated by the green line on the upper right side of the slide. As for our leverage target for 2017, we believe 2x EBITDA to be a comfortable level for the company on a recurring basis assuming Comgás' normalized EBITDA. And just a quick highlight on the consolidated gross debt on a pro forma basis that fell 5% due to the reduction of Raízen's debt balance and mark to market of the perpetual bonds whose principal is no longer hedged.

The average cost of debt on a pro forma basis i.e. including Raízen was of 90% of the CDI and 102% if we exclude Raízen. Now the free cash flow to equity, the main drivers compared to the same period last year were 4% higher operational cash flow driven by Raízen Energia as the positive impact of the currency hedging is included and this quarter also had a lower variation of Raízen Energia's working capital due to the anticipation of the crushing period last crop year increasing the inventory line. The cash flow from investments grew this quarter due to the payment of BRL276 million on shares previously owned by TPG due to the execution of a put option owned by the funds since their investment in logistics business back in 2009. And in the financing cash close – the variation cash flow – sorry, the variation has to do with seasonality in interest payments namely from the 2027 bond. These effects resulted in a lower free cash flow to equity generation of BRL139 million in the first quarter of 2017.

Let's move to the last slide to wrap up the earnings presentation. Once again, we show our guidance for 2017. There has been no change whatsoever to the numbers presented last quarter. We are actually confirming the guidance for Raízen to the '17/18 crop year using the same assumptions described in our last conference call. So this is all. We are ready to move to the Q&A session.

Question-and-Answer Session

Operator

Paula Kovarsky

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

Operator

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