Q2 2017 Earnings Call

Company Participants

- Andre Pires, Chief Financial and Investor Relations Officer

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to Ultrapar's Second Quarter 2017 Results Conference Call. There is also a simultaneous webcast that may be accessed through Ultrapar's website at www.ultra.com.br/ri in MZiQ platform. Please feel free to flip through the slides during the conference call.

Today, with us, we have Mr. Andre Pires, Chief Financial and Investor Relations Officer, together with other executives of Ultrapar. We would like to inform you that this event is being recorded and all participants will be in listen-only mode during the Company's presentation. After Ultrapar's remarks are completed, there will be a question-and-answer session. At that time, further instructions will be given. (Operator Instructions) We remind you that questions, which will be answered during the Q&A session may be posted in advance in the webcast. A replay of this call will be available for one week.

Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor of Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of Ultrapar 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 Ultrapar and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I'll turn the conference over to Mr. Pires. Mr. Pires, you may now begin the conference.

Andre Pires {BIO 17698724 <GO>}

Thank you very much. Good morning, everyone. It's a pleasure to be here with you to discuss Ultrapar's second quarter of 2017 results. Here with me are the leaders of our businesses, as well as the Investor Relations team to help answering your questions.

I'd like to take this first opportunity after the announcement of the CEO succession to welcome Frederico Curado. He will take office as the new CEO in October and will continue the journey to strengthen Ultra's strategy that has been conducted by Thilo.

Curado joined our team as part of the planned transition process on July 3rd, and this man has intensively dedicated his time to interact with the Company and its people. Thilo will continue to lead Ultrapar until the end of the current quarter and will remain with us through the end of December to support this transition process.

I'd like to open our discussion today in slide number 3 with an overview of the main developments at Ultrapar since our last call three months ago. As announced in June 2016, the acquisition of Alesat by Ipiranga was submitted to CADE, the Brazilian Antitrust Authority. Through over the last 14 months, we worked intensively to demonstrate all the benefits involved in this transaction, as well as to offer an agreement, which addressed the concerns raised by CADE. Nevertheless on August 2nd, CADE's Administrative Board decided to reject the transaction. Consequently, the acquisition will not take place anymore and neither of the parties will be subject to any penalties. We did everything possible to reach an agreement and were absolutely focused on approving the transaction. On the other hand, we respect CADE's decision and intend to continue pursuing other growth beds for Ipiranga and Ultra. Specifically for Ipiranga, we have more than BRL1 billion of CapEx focused on organic investments for 2017, as well as the joint venture with Chevron in lubricants.

Talking about the JV, in early August, we had the closing of this deal to create the second largest lubricants company in Brazil. The results will be consolidated until the end of the year. I would also like to remind that the acquisition of Liquigas continues under analysis by CADE under general superintendency level. It is important to clarify that the two operations, Ale and Liquigas, have their own dynamics and their markets have different characteristics. We expect a ruling from CADE up until March 2018, and until then, Ultragaz and Liquigas will remain as competitors, managing their own businesses as usual.

Touching on the economic environment, the second quarter was a very challenging one for the market as a whole, even for Brazilian companies despite early signs of recovery. On the other hand, we also recognized that various effects impacting our results were atypical or non-recurring, as I will explain later for each business. As I mentioned back in the end of 2016, we already expected the first half of the year to be weaker. The outlook for the second half is for a more stable business environment. Together with investments and the strategic initiatives we implemented, we are optimistic about better conditions to come, allowing us to pursue a sustained growth path, both in 2017 and further into the future.

Our solid financial position and the confidence in our outlook allowed us to accrue BRL462 million in dividends, equivalent to BRL0.85 per share. This amount is 6% higher than the dividend declared on earnings for the first half of 2016. This represents a 2.4% annualized dividend yield over the average share price in the first semester and a 75% payout ratio, considering our year-to-date earnings. The continuation of our CapEx plan of close to BRL1 billion in the first half of 2017 reinforces our conviction that we can keep generating value from our capital allocation strategy. We continue expanding our scale and the quality of our operations, as well as intensifying our differentiation and modernization initiatives.

I also remind you that Ultrapar has an organic investment plan for this year of BRL2.2 billion. As I will show you further in this presentation, we are already reaping some benefits of this investment in our businesses, both in the Otto cycle volume as a result of this related expansion of our service stations and in Ultragaz bottled segment growth following initiatives to add new resellers. As we had mentioned, both our organic and inorganic investments and the characteristics that have marked our businesses over the years allow us to look ahead with optimism and confidence.

Let's now move on to slide number four and go through the performance of our businesses, starting with Ipiranga. The accelerated expansion of the service station network at Ipiranga was one of the key growth levers driving Otto cycle volumes in the first half of 2017. The network grew by 6% on a year-on-year basis with a net addition of 464 service stations in the last 12 months, 180 in the first half, and 95 in the second quarter. We closed 146 service stations in the last 12 months and 20 in the quarter within the historical average. At the end of June, Ipiranga's network reached more than 7,700 stations. The benefit of this expansion will be progressively seen during the course of the year as the network matures. The majority of the service stations added includes am/pm continued stores. In the first half of 2017, we opened 94 continued stores, 55 jet oil franchises, and 53 bakeries. These investments enhance Ipiranga's strategy of constant innovation in services and convenience, helping to increase the flow of the station, customer satisfaction, and loyalty. With this strategy, customers have higher value-added products and services, while resellers are provided with an additional source of revenue and differentiated positioning, whilst maximizing the value creation of the team as a whole, including Ipiranga's.

Ipiranga's volume in the second quarter of 2017 remained stable in relation to the second quarter of 2016. This performance reinforces the gradual recovery trend since the fourth quarter of 2016, when consolidated volume reduced 14% on a year-on-year basis. After six consecutive quarters of decline, Ipiranga's volume in the Otto cycle rose 6% on a year-on-year basis. This was mainly influenced by investments in Ipiranga's network expression and a pickup in light vehicle sales nationwide. Diesel volumes were 5% down compared to the second quarter of 2016 in spite of improved performance of the wholesale segment, as the demand for diesel continued to suffer the effects of weak economy.

As for the results, we were impacted by some specific events. Ipiranga reported an EBITDA of BRL582 million in the second quarter of 2017, 19% lower than in the second quarter of 2016, largely due to inventory effects from cost reduction in gasoline, ethanol, and diesel, as well as the concentration of some specific expenses in the quarter. The cost reduction in the recent months not only reflects international price movement, but also a reduction in the arbitrage opportunity between local prices and import parity.

Let's now look at the trends and our view for the current quarter. It is always important to remember that this is not about specific forecast, but rather tendencies, levels, and order of magnitude and trending results. In Ipiranga's case, our operations will continue to benefit from the accelerated expansion of our service station network in the Otto cycle and for market share recovery in the wholesale segment in the diesel market. The results in the coming quarters will reflect a growth in sales volume and the positive effect on cost and inventory variations. Therefore, we keep our growth outlook for the full year.

And moving on now to Oxiteno in slide number 5. Volumes of specialty chemicals in Brazil increased by 3% compared to the second quarter of 2016, the fourth consecutive quarter on year-on-year growth as a consequence of the larger recovery in the Brazilian economy and the development of new product and solutions for our clients. The highlights for the business segments were in the oil and gas and automotive fluids. Growth in international market was 3%, with higher sales to the Unites States. This is a pre-marketing strategy of our expansion at the Pasadena plant in Texas. Commodities volume presented a 15% year-on-year decrease, reflecting the product's volatility and demand, leading up to a 1% drop in consolidated volumes. As I mentioned in the first quarter, volatility in raw material prices continued to squeeze margins and led to an inventory loss due to the sharp decline in palm kernel oil prices. We also had some technical issues in starting the oleochemicals plant in Camacari after its scheduled stoppage. The plant is operating normally now. These one-off effects combined had a negative impact of BRL37 million on the second quarter results. In addition to this specific event, the BRL was 8% stronger against the US dollar year-on-year. Consequently, Oxiteno's EBITDA was BRL34 million, an year-on-year decline of 71%. If we exclude the non-recurring effects of BRL37 million, both with the inventory loss to the PKO priceS reduction and the cost related to the technical issueS in restarting of the oleochemicals plant in Camacari, we would have reached an EBITDA of BRL71 million.

For the current quarter, we expect continued growth in sales volume and, therefore, results will evolve positively compared to the second quarter. FX-related inventory loss and the extended stoppage of the oleochemicals plant will be felt only until the third quarter. In parallel, we continue to implement Oxiteno's expansion project in the United State, which is on schedule to initiate operations in the beginning of 2018, allowing Oxiteno to significantly increase its footprint in the largest ethoxylates market in the world.

Moving on now to Ultragaz, in slide number 6. In the second quarter of 2017, Ultragaz consolidated sales volume reached 445,000 tonnes, stable compared to the same period of 2016. The growth in the bottled segment reflected investments to add new resellers and was offset by an year-on-year decline in bulk segment, which was impacted by peak sales volume to industrial clients in the second quarter of 2016 and by the loss of some customers to natural gas. We also had the effect of two fewer business days in the second quarter of 2017. Excluding the two business days' effect, volume would have grown 2.4%.

Ultragaz EBITDA amounted to BRL124 million in the second quarter of 2017, a 14% growth over the second quarter of 2016, reflecting both commercial initiatives to add new clients and resellers, as well as a differentiation strategy based on innovation. The expectation for the current quarter is a continuity of the growth pace seen this year. Therefore, we keep our outlook for a growth in 2017, similar to what we had in 2016.

Let's now move on to slide number 7 and talk about Ultracargo, our liquid bulk storage business. Ultracargo's average storage increased by 10% compared with the second quarter of 2016, largely due to increased fuel handling activity at the terminals in Aratu, Suape, and Santos, as well as the result of the partial resumption of the operations at the Santos terminal in June. The average capacity utilization in the second quarter was 93%, even considering the capacity still available at the Santos terminal. Ultracargo posted EBITDA of BRL26 million in the second quarter of 2016, a 38% year-on-year decline, mainly due to the BRL30 million revenues from insurance claims in the second quarter of 2016. Comparing the same quarters and excluding expenses and insurance relating to the fire and the non-recurring effect of asset disposals in 2017, which are shown in the graph on the right hand side, recurring EBITDA increased by 63%. This reflects greater average storage, as well as higher average prices. For the current quarter, the dynamic is quite similar, and we continue to see same levels of storage with similar EBITDA levels compared to the previous quarter.

Moving on to slide number 8 with Extrafarma. Extrafarma ended the second quarter with 341 drug stores with 78 openings in the last 12 months. During the quarter, we added 22 new stores, two of which in the state of Bahia, the 11th state where Extrafarma is present. At the end of the second quarter of 2017, 47% of all stores were operating for less than three years compared to 40% in the second quarter of 2016. Second quarter gross revenues at Extrafarma grew by 18% compared with the second quarter of 2016 due to a 22% growth in retail sales as a result of a greater number of stores and a 10% increase in same-store sales. The annual price adjustments for pharmaceutical drugs set by the price regulator of the pharma market averaged 3% this year against 12% in 2016. Market data from Abrafarma shows such a wide increase in revenues of 7%, an indication of Extrafarma's outperformance compared to the market as a whole.

Second quarter EBITDA amounted to BRL10 million, BRL2 million lower than the second quarter last year, mainly due to the increased share of stores that are still maturing and the higher inventory gains related to the annual price adjustments in the second quarter of 2016. These effects were partially offset by the 10% increase in same-store sales and by initiatives implemented to raise management standards in the retail pharmacy network, particularly on the cost reduction side. Excluding the effects of the new drug store opening, Extrafarma has presented the low inflation increase in expenses. For the current quarter, we expect to further accelerate the expansion pace towards the objective of opening 100 stores in 2017. For EBITDA, our expectation is a similar level to what we have in the second quarter, which means a growth compared to the same period of 2016.

Now, moving to slide number 9. And before I close the presentation today, I would like to outline some characteristics of our businesses that base our expectations for the year as a whole. While showing signs of a gradual recovery, economic conditions continue to be challenging. The resilience of our business model lies in the diversification and differentiation of our products and our services and will continue to be one of the key factors in our growth plan. We have seen some indications of a rebound in volumes for our businesses suggesting that the recovery may take place in the short-term for those segments that are more closely linked to overall economic performance.

Despite market trends and economic environment that are still not that inspiring, we are confidence in the performance of the businesses and in Ultra's sustained growth in 2017 with the acceleration in the expansion of Ipiranga's network, the focus on the specialty chemicals, innovation, international expansion in Oxiteno, the differentiation strategy at Ultragaz; the resumption of activities at Ultracargo's Santos terminal, and the further acceleration in Extrafarma's expansion.

With this, I conclude today's presentation. I'd like to thank you for your attention. And we welcome any questions that you might have. Thank you.

Questions And Answers

Operator

Thank you. The floor is now open for questions. (Operator Instructions) Since there are no questions, this concludes the question-and-answer session.

At this time, I would like to turn the floor back to Mr. Pires for any closing remarks.

A - Andre Pires {BIO 17698724 <GO>}

Well, thanks for your participation. And just before I conclude, a very -- let's say, a question that's showed up in our call early on in Portuguese was about the size of the inventory losses that we had in the second quarter related to the price movements in diesel and gasoline and ethanol. And since we gave this information in the conference call in Portuguese, I thought it was important to give the same information as well in the conference call in English. So the level of inventory losses in the second quarter for Ipiranga was around BRL100 million. So I wanted to make sure that this information is the same for everyone.

So with that, I conclude. And thank you, again, for your participation. And I hope to talk to you again in the conference call for the third quarter results early November. Thank you very much.

Operator

Thank you. This concludes todays Ultrapars second quarter 2017 results conference call. You may disconnect your lines at this time.