Q2 2020 Earnings Call

Company Participants

- Andre Pires de Oliveira Dias, Chief Financial and Investor Relations Officer
- Frederico Curado, Chief Executive Officer

Other Participants

- Frank McGann, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to Ultrapar's 2Q '20 Results Conference Call. There is also a simultaneous webcast that may be accessed through Ultrapar's website at ri.ultra.com.br and the MZiQ platform. Please feel free to flip through the slides during the conference call. Today, with us, we have Mr. Frederico Curado, Chief Executive Officer; and Mr. Andre Pires, Chief Financial and Investor Relations Officer, together with other executives of Ultrapar.

(Operator Instructions)

Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor and 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, dependent 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. Curado. Mr. Curado, you may begin the conference.

Frederico Curado {BIO 2004589 <GO>}

Thank you. And welcome, everyone, to our quarterly call. This quarter, of course, we felt the direct impact of we call the COVID-19 pandemic. But in retrospect, we believe that our ability to manage our operations during the this crisis feels quite efficient. And we were actually able to go through these 3 challenging months better than we expected.

So now since the end of March, we established three priorities: first, the safety of our people and the second being the continuity of our operations. Let's keep in mind that all of our sub businesses were considered essential to the population. And we have an obligation to keep our customers and our consumers properly serviced, regardless of the challenges.

So as far as our people go, we have had about 500 concerned cases so far, which is about equivalent to about 3% of our team. Of those 500 cases, about 450 have already recovered and returned to work. The remaining around 50, they are fulfilling the quarantine. But thanks God nobody is actually -- everybody's at home, nobody -- even in hospitals.

So if we consider most of our staff was in the field, I think you can say that our protocols for symptom identification, for testing, selective isolation and monitoring, those protocols have been very efficient. Of course, also we have staff in home office. We began to return to offices last month, actually on August 3rd, middle of last week. This return is gradual. It's very smooth, and it's going on quite well so far.

I believe that the vast majority of companies have realized we certainly have ourselves the home office has been working extraordinarily well, far beyond what -- yes, one might expect in navigating this COVID crisis. So we don't know when or how -- what will be the new normal of office work, how do we look like in the future. But surely, we don't think we will have 100% of our people driving back and forth everyday to office. We don't -- we think this is -- there will be -- there will be some changes to that. And the experience of the next months, several months, I think, will tell us where we're going to land as far as balancing in our home office and after presence in the office. So it's been a very interesting learning in this whole period.

Now with regards to the certain priorities of operational continuity, we actually managed to maintain all of our operations without any interruption whatsoever, despite the logistical mobility challenges that we experienced here in Brazil in Sao Paulo in particular, (inaudible). But we did not have a single day of interruption, which is great. So it's no small thing, yes. I think we have to recognize the quality and the tenacity of our teams, also our leaders they will have gone the extra mile in the spirit of hardship and have kept our people safe and engaged with our commitments.

Now before talking about the results, let me just touch on a few other points about the crisis, one, support for our resellers and through the social actions and support to the fight against pandemic. So in short, we keep a very proactive attitude, I mean we're agile, and we are flexible with our suppliers, with our customers, our partners, our resellers in an attempt to preserve integrity, not only of our operations but of their operations as well and ultimately keep the services to the population.

So we were proactive in renegotiating contractual obligations that we were proactive in working in some capital relief measures. So our partners in the ancillary did ensure the continuity of the value chain -- or value chains, but also the stability of the level of default in our balance sheet, which did not go in the quarter. So that's another important result.

And one last word on the price of -- regarding social support. So we're going about reductions, about BRL200 million -- sorry, BRL20 million to mainly to the construction of the hospitals, always in partnership with private hospital operators and then compared with our current result as it was the case in Rio and Porto Alegre for example. We also donated LPG, delivered medical equipment, meals for truck drivers. We granted huge discounts for the health professionals among several other actions.

Okay. So let's move now to the financial results. The impact of the crisis was concentrated in Ipiranga, as you probably read in our release, and that, of course, that intent was a result of the combined effort -- combined declines of one significant reduction in demand, mainly gasoline and ethanol and through the sharp decline in oil pricing, of course, we generated a huge loss in inventory value, which, of course, we view with COVID over time.

So the other businesses, on the other hand, they showed enormous resilience to the crisis, including Extrafarma, which went through the quarter with about 7% of its stores are closed, stores which were located -- which are located in shopping malls, which were shut down.

So commenting briefly on the other businesses, Ultragaz had a very good quarter. We did experience some reduction in volume for the bulk customers. These are small and medium sized enterprises. But we saw growth in the household consumption. And we were able to sustain good margins in both segments, bulk and household.

Shifting to Ultracargo, also a good quarter there. Despite a small reduction in movement of cargo, but the storage commitments remain very firm, and the margins also remained firm. So it was a good quarter for Ultracargo.

And finally, Oxiteno. We had some reduction in volumes for some segments such as coatings or paintings, oil and gas, obviously, and automotive. But on the other hand, the agri business and the HPC sector they exceeded our expectations. In addition to that, Oxiteno has benefited from the value exchange rates, weaker real and also the drop because of ethylene in the next quarter.

So in short, we had a difficult second quarter for sure. But that tested the resilience of our -- and the agility of our trend in our portfolio with results that we deem very satisfactory given the uncertainties and the volatility that we all experienced. So we anticipate a second half a continued recovery in economic activity in Brazil. And of course, Ipiranga with that recovery. So we believe -- we really believe that the greatest difficulties are behind us already.

So we're hoping that in the next several months also is important. With implementation of the Abastece Ai, that we'll try new business announced a few weeks ago. That business, we believe they will -- inflated value, and we really hope to materialize that in coming years. So that's the start-up phase of this new business.

A word on our strategic agenda is our strategic vision, they remain unchanged. On one hand, of course, we continue to pursue improvements of results in all of our businesses.

On the other hand, also a lot of discipline, focus on cash management and also, of course, in capital reallocation. I also could not -- I have to mention that all of that has to be supported by continues development of our pipeline, our talent and also what you call entrepreneurial leaders.

Let me make one last comment before giving the floor to Andre. We -- I mean, we could not advance dividends in this semester, but the company maintains -- absolutely maintained its commitments to pay the main dividend equivalent to 50% of our annual net income, which, by the way, is in the company bylaws. So we decided not to make this half yearly advance as has been our practice over the years, it will be the context of cash preservation, in context of an economic scenario, which is still uncertain and volatile. So obviously, as usual, the dividend proposal related to the 2020 fiscal year, this has went to approval, along with the financial statements for next year in our AGM. So, no change there. The only change is that we did not advance dividend at this stage.

So with that, over to you, Andre. Thank you.

Andre Pires de Oliveira Dias {BIO 17698724 <GO>}

Thank you, Fred; and good morning, everyone. Starting now with Ultragaz on Slide number 5. Sales volume at Ultragaz in the second quarter of 2020 increased by 3% on an year-on-year basis, in line with the market. In the bottled segment, volume grew by 8%, influenced by stronger residential demand for LPG, reflecting the restrictions in place due to the pandemic.

On the other hand, bulk sales volume fell by 9% with lower sales to industry, commerce and services, also impacted by the pandemic. This reduction was offset by a growth in sales to condominium and for special gases.

SG&A fell by 11% versus the second quarter of 2019. Thanks to steps taken to control expenses with lower expenditures on payroll, business travel and events. In contrast, there was an increase in freight expenses due to higher sales volume and additional expenditures with donations and for protective equipment in order to tackle the pandemic. As a result, Ultragaz EBITDA reached BRL206 million, a 69% growth compared to the same quarter of last year due to the increase in sales volume, improved operational efficiency and focus on cost and expenses control.

Looking ahead at the Ultragaz business environment, we expect to see a gradual recovering sales volume for the bulk segment, mainly coming from industry, commerce and services and a continued robust performance in the bottled segment. With that, the trend is to maintain solid and consistent results going forward.

Moving on to Slide number 6, talking about Ultracargo. Ultracargo added 19% to its average capacity compared to second quarter last year due to the expansion at the Santos and Itaqui terminals implemented over the past 12 months. The cubic meter sold increased by 16%, mainly due to the greater handling of fuels and expanded capacity, in addition to the increase in spot operations in Aratu. Ultracargo reported BRL155 million of net revenues in the quarter, 23% above the second quarter of 2019, driven by higher average tariffs, new customers and a large number of spot operations.

Regarding costs and SG&A, we had a combined increase of 4% due to higher payroll expenditures as a consequence of the capacity expansion at the Santos and Itaqui terminals and additional expenses with donations and EPIs related to COVID-19. It is important to highlight that Ultracargo reduced its OpEx per cubic meters sold by 10%, demonstrating an improved productivity.

In the second quarter of 2020, Ultracargo's results benefited from tax credits of BRL12 million while in the same quarter of last year, we had a negative impact of BRL53 million in connection with the settlement related to the fire incident in 2015. Ultracargo's EBITDA reached BRL92 million in the quarter. If we exclude the non-recurring impact already mentioned, the year-on-year EBITDA growth was 35% due to increased operations and the rationalization and dilution of costs and expenses. The EBITDA margin in the quarter was 59%.

Despite the impacts of the pandemic, the outlook is for maintaining the capacity utilization level with a gradual recovery in handling throughout the second half of the year. In addition to initiatives to increase productivity indicated continued EBITDA growth year-over-year. Ultracargo remains focused on its capacity expansion by increasing its footprint in the ports where it already operates, as well as expanding toward new regions such as in Vila do Conde, state of Para.

Moving on to Slide number 7, talking about Oxiteno, where total volume decreased by 9% and the volume of specialty chemicals was down by 5% compared to the same quarter in 2019 due to a drop in coatings, automotive and oil and gas, despite the increase in the Crop Solutions and Home & Personal Care segments.

Oxiteno's quarterly results benefited from better contribution margins in dollars per ton, driven by a richer sales mix and by the effect of the devaluation of BRL against the US dollar. SG&A rose by 3% due to the FX translation effect at the overseas operations and increased expenses with international freight, following the increase in exports.

Oxiteno remains committed to reducing costs and expenses and we have already noticed in this quarter, a reduction in expenses with payroll, business travel and services in general, which contributed to preserve the results for the period. With this, Oxiteno's EBITDA was BRL162 million in the quarter, a growth of BRL117 million compared to the second quarter of 2019, resulting from better unitary margins in US dollar and the BRL devaluation despite lower sales volume.

Oxiteno's outlook is to maintain the current volume levels for the most resilient segments such as Home & Personal Care and Crop Solutions and a gradual recovery in segments more impacted by the pandemic, notably Coatings. In addition, the positive effect of the exchange rate depreciation on Oxiteno's results, combined with the ramp-up at the Pasadena plant and better unitary margins, maintain the expectations for an year-on-year growth in EBITDA.

Moving now to Slide number 8, talking about Ipiranga. Ipiranga saw an 18% year-on-year drop in sales volume with a decrease of 28% in Otto cycle and 7% in diesel due to the significant impacts of the pandemic on fuel consumption in Brazil, mainly in April, followed by a gradual recovery in May and June. Total sales volume at Ipiranga in April declined by 27% on an year-on-year basis, while it fell by 17% in May and 7% in June.

We ended the second quarter with a network of 7,105 [ph] service stations, a gross addition of 94 and 95 churn in the period. The am/pm network ended the quarter with 2,345 stores, of which 17 are company-operated stores, all located either in Sao Paulo or Rio de Janeiro. The outcome of the pandemic on the global economy, in addition to the price war in international markets, affected the supply and demand balance in the oil market, triggering sharp price volatility for gasoline and diesel.

The prices for products fell dramatically in late March and April followed by a partial recovery in May and June, besides the price of ethanol also fell by 25% in April. Consequently, Ipiranga incurred significant inventory losses in the quarter due to the remaining effects of the price drop in March and also due to the additional prices reductions within the second quarter itself.

However, Ipiranga posted SG&A reduction of 32% compared to the second quarter of 2019. This was a consequence of the initiatives deployed to cut expenses on several fronts, especially related to payroll and marketing, as well as freight expenditures, the latter linked to a weaker sales volume. In addition, we kept our focus on optimizing working capital that contributed to a growth in operating cash generation compared to the second quarter of 2019.

With that, EBITDA was BRL179 million, a reduction of 65% compared to the second quarter of 2019, mainly related to the lower sales volume and the impact from the price drop mentioned, which were partially offset by reduced expenses. It is worth mentioning that the results for June represented an important evolution compared to the results for the rest of the quarter. The trend is for gradual recovery in volumes and results, although still in level below last year, and also with lower volatility in fuel price. We saw -- we observed this evolution in June and we continue to see the same evolution in the beginning of the third quarter.

Talking now about Extrafarma, moving on to Slide number 9, Extrafarma ended the quarter with 410 stores, practically stable compared to the first quarter of 2020. Of these units, 38% are still in the ramp-up phase compared to 53% in the same quarter last year, reflecting greater selectivity in the expansion and the adoption of a more rigorous approach to underperforming stores.

Gross revenue in the quarter was BRL515 million, 8% down compared to the second quarter of 2019 mainly due to the 5% lower number of stores and the temporary closing of 7% of the stores located at shopping malls due to the pandemic. However, the stores that remain in operations registered an increase of 4.6% in same-store sales, driven by the strengthening and expansion of home delivery operations, as well as through partnerships with delivery apps. Gross profit reached BRL141 million, a 7% fall on a year-over-year basis and corresponding to a gross margin of 27.5%. SG&A expenses fell by 15% in the quarter, thanks to a smaller number of stores and initiatives to improve productivity and optimize logistics, with emphasis on the reduction in payroll expenses and the opening up of distribution center in Sao Paulo in the third quarter of 2019.

With this, EBITDA was BRL14 million in the quarter excluding the non-recurring credits of BRL16 million recorded in the second quarter of 2019, the EBITDA showed a BRL12 million improvement compared to the second quarter of 2019 due to the operational improvements made in previous quarters and despite the impacts of the pandemic.

Currently, all stores are operating and pharma sales remain resilient, despite the lower flow of customers, especially in drug stores located in shopping malls. We are continuing with our initiatives related to operational improvement, digital development and cost reduction. And therefore, the outlook is for continued EBITDA growth on a recurring basis.

Moving on to the consolidated results for Ultrapar on Slide number 10, net revenues were BRL16 billion, 27% less than the second quarter of 2019, due to the impact of the pandemic. EBITDA was BRL611 million in the quarter, a decline of 10% from the same period in 2019. If we exclude the non-recurring impacts that we have already mentioned, EBITDA was BRL599 million, a decrease of 18% in the quarter, mainly due to the sharp decline in EBITDA at Ipiranga that was impacted by the social distancing measures, offset by an increase in EBITDA from other businesses. We posted net financial expenses of BRL80 million in the second quarter compared to BRL92 million in the same period of last year, a reduction of 13%, largely due to the payment of the premium on the tender offer of notes in the second quarter of 2019, which increased interest expenses last year.

This effect was partially offset by the appreciation of Ultrapar stock price over the subscription warrants issued at the time of the acquisition of Extrafarma, and that had a negative impact in the second quarter of 2020. Net income was BRL50 million, 59% less than the second quarter of 2019, mainly the result of lower EBITDA. In this quarter, management opted for not paying out the interim dividends for the current year in order to preserve the Company's cash. As it is stated in our bylaws, the minimum mandatory dividend will be paid out after the disclosure of the full year's results. Capex was BRL351 million, an increase of 7% compared to the second quarter of 2019, largely due to higher investments in Ipiranga, maintaining the service station network, and in Ultragaz for replacing and acquiring gas bottles.

In April, we announced a reduction of up to 30% in our investment plan for 2020, and in the second quarter, we implemented a greater control over investments as a measure to preserve cash. The optimization of working capital contributed to an operational cash generation of BRL1.8 billion. If we discount net cash used investment activities, excluding financial investment, cash generation was BRL1.4 billion, an increase of 33% over the first half of 2019.

Moving on to Slide number 11 and talk about our debt profile, we ended the quarter with a leverage ratio of 3.2 times measured by net debt to adjusted EBITDA for the last 12 months, a slight reduction compared to the 3.3 times for the first quarter of this year. This was only possible thanks to the strong cash generation in the quarter, which more than offset the sharp drop in EBITDA. It is worth mentioning that from the first quarter of 2020, with the implementation of IFRS16, we began to include leases payable in our calculations of net debt, which contributed to an increase in leverage, despite these leases, as you know, not being classified as bank debts.

We ended the quarter with a cash position of BRL8.4 billion, boosted by the cash generation in the period and by new funding. In July, we announced the issuance of $350 million in notes with a coupon and a yield of 5.25% per year through the reopening of the notes maturing in 2029. The proceeds will be used for bringing down debt with shorter maturities and for lengthening the debt profile.

With this, I conclude my presentation and we can now move to the Q&A sessions. Thank you.

Questions And Answers

Operator

Thank you. (Operator Instructions) Our first question comes from Frank McGann with BoA. Please go ahead.

Q - Frank McGann {BIO 1499014 <GO>}

Yeah, thank you very much. Two questions if I might. One, you mentioned that you have seen some pickup most notably in June, it seems, post the sharper reductions in activity earlier in the second quarter. I was just wondering, if you could just provide a little more information for the various segments as to how you actually saw July and August perform so far year-over-year or versus the prior quarter.

And secondly, just in terms of the potential for refining investment, I was just wondering what your current thoughts are now on how you're seeing it, what type of participation you would have in any investment there and how you would see financing that?

A - Andre Pires de Oliveira Dias {BIO 17698724 <GO>}

Okay. Frank, thanks for the questions. Yes, we've seen from the end of the second quarter and also beginning of the third quarter, a recovery in terms of volumes that were, let's say, very, very clear to note every time that we see more flexibilization in terms of the social business measures. Just to give an idea, right, if we were, let's say, in the end of the second quarter, we were seeing levels of consolidated volumes decline compared to let's say a year ago, around 14%. Today, these levels are below 10%. They're likely 8% less.

So, if you take the last week of June, for example -- sorry, the last week of July as an example, the levels of decline in Otto cycle are around 10%. And remember that during the second quarter, they were closer to 20%. Diesel is already up, around 2% up compared to the same week a year ago and the total volume is around 8% below a year ago if we take the last week of July. So this is an indication that there is a consistent recovery in terms of volumes, and there is a strong correlation between those volumes and every time that we see people somewhat going back to a more normal life and moving around more frequently.

So there's a very clear correlation. As for refining and the participation, basically, looking at, let's say, what we see as a positive outcome of Petrobras selling 50% of its refining capacity, we believe that this is going to be positive for the market in general terms. There will be, in our point of view, benefits, not only for the fuel distribution companies but also for the final consumer in the end, right, I mean the players with more scale, be able to negotiate long-term contracts, volume discounts. But this is going to take some time until it starts to let's say, impact the market because the process is ongoing. It's going to take some time for it to be included.

Specifically about ourselves, and since the process is ongoing, we cannot comment specifically on the situation on our end. But conceptually, in general terms, we see this move of Petrobras privatizing 50% of its refining capacity has been something very positive for the market.

Q - Frank McGann {BIO 1499014 <GO>}

Okay. Thank you very much.

Operator

Showing no further questions, this concludes our 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 de Oliveira Dias {BIO 17698724 <GO>}

Well, thank you very much. Thanks everybody for the interest, and I hope to see you all again when we release our third quarter results. Thank you and have a good day. Bye-bye.

Operator

Thank you. This concludes today's Ultrapar's 2Q20 Results Conference Call. You may disconnect your lines.