

Q2 2014 Earnings Call

Company Participants

- Andre Covre, Chief Financial and Investor Relations Officer

Other Participants

- Christian Audi, Analyst
- Frank McGann, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to Ultrapar's 2Q'14 Results Conference call. There is a simultaneous webcast that may be accessed through Ultrapar's website at www.ultra.com.br/ri. Please feel free to flip through the slides during the conference call.

Today with us, we have Mr. Andre Covre, 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 the 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. Covre, who will present Ultrapar's results in the quarter and discuss about perspectives. Mr. Covre, you may begin the conference.

Andre Covre {BIO 15233513 <GO>}

Good morning, everyone. It's a great pleasure to be here with you to discuss Ultrapar's performance in the second quarter, which was another quarter of earnings growth. Here with me to help answering your questions, I have the Executive Officers of our businesses and Investor Relations team.

Before continuing, I'd like to draw your attention to Slide number 2, where we highlight the criteria adopted in the preparation of the information in this presentation and the information that was disclosed. This slide also brings some information regarding the association with Extrafarma.

I'd like to start our discussion highlighting Ultrapar's consolidated performance. The recent economic environment in Brazil was characterized by inducing expectations of GDP for 2014 according to the research published by the Central Bank, stable exchange rate and soaring interest rate.

Even in this increasingly challenging economic environment and with the negative one-off events that we had anticipated in our last conference call in this quarter, we presented consolidated EBITDA of R\$751 million and net earning of R\$301 million, both representing a 6% growth compared to the second quarter of 2013 and in line with expectations transmitted to you in the last conference call.

We have completed our 32nd consecutive quarter of annual EBITDA growth, reaching eight straight years of uninterrupted growth. And as you certainly know, during these 30 years, we had a number of combinations of Brazilian GDP exchange rates, interest rates, inflation, oil prices, national-economic environment and et cetera, and not to forget between 2008 and 2009, we had a financial economic crisis.

Our consistent earnings growth and consequent cash generation has allowed the company to pay increasing dividends over time and this time, it's not different. A payment of 390 million in dividends for the first half of the year was approved, amount that is approximately 10% higher than the dividends related to the earnings in the first half of last year, indicating our confidence that our good performance will continue.

We also had the honor of receiving an another important market recognition. We ranked first in the Agencia Estado Awards as the most attractive company for shareholders in 2013, considering performance of the company, its covenants, and performance of the stock. Agencia Estado is a renowned institution in Brazil, part of one of the most important newspapers in the country. We are particularly pleased with the awards, because this is our four consecutive year among the top 10 companies, attesting the consistency of our company's performance.

Moving on to Slide 4, I'd like to comment in any further detail the performance of businesses, starting with Ipiranga. Consistently with prior EP rates, the volume growth was driven mainly by the increase in the light vehicle fleet, which positively influences gasoline and ethanol sales.

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As you can see in the top left chart, the average Brazilian vehicle fleet is estimated to be growing at 6% compared to 2013. The dissimilation, we assume that the 7% drop in car sales registered in the first half of the year will remain for the full year. Another factor that has boosted our growth is the expansion of the Ipiranga's service station network. We have been investing in new service stations and conversion of unbranded service stations and finished the second quarter was 6,824 stations, up 5% from late June 2013. These investments have allowed the company to grow above the market in the sales to gas stations, also known as the reseller segment, obtaining an improved sales mix with increasing share of the reseller segment as shown in this chart on the top right.

From the marketing standpoint, we continue to move forward with our strategy of differentiation through constant innovation in services and convenience, helping to increase the flow of customers at the service stations, customer satisfaction, and customer loyalty. This philosophy has been successfully developed through some marketing campaigns. The most famous campaign carries a slogan 'Ask at the Ipiranga Service Station', which summarizes the value proposition to Ipiranga's clients.

With all of this, we had a 3% volume growth in the second quarter of the year compared to the same period last year with a 7% increase in fuels for light vehicles volume that we anticipated in the last conference call that we should expect lower volume growth in this quarter, since we would have two working days less in the quarter. This in fact is due to the Easter and another regional holidays, which in 2013 respectively in March and on a Sunday. Those two working days represent a reducing effect in volume growth of approximately 3%.

Another influencing factor we anticipated was the increase in marketing and advertising expenses mainly related to the Soccer World Cup. Taking advantage of large audiences event has strengthened our marketing position and our brand loyalty. This in fact responded to a throughout 1 million higher advertising and marketing expenses in the quarter. EBITDA totaled 521 million, up 9% from the second quarter last year, as a result of the above mentioned factors.

We estimate that the fact of the two working days in the quarter corresponding to 3% to the volume, multiplied by our contribution margin of about 115 or 120 cubic meters. If we were to add these 20 million back and the 12 million of additional advertising marketing campaigns, we would have had EBITDA of approximately 550 million, a growth of 15% compared to the last quarter, which is also the trend for the third quarter.

Now moving to Slide 5, I'd like to try to clear after the recurring [ph] question in our interactions with the market that I think it's worth spending a few minutes. The idea of this slide is to show how an eventual drop in sales of new vehicles has little influence on the fleet growth and consequently on the combined volume of gasoline and ethanol. The first chart on the left shows the strong correlation between the growth of the ARPU cycle volume and the expansion of the light vehicle fleet in Brazil.

To eliminate the distortions caused by the difference of energetic power between gasoline and ethanol, we converted the entire series of volume into gasoline equivalent

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volume. And the chart on the right will show the low penetration of vehicles in Brazil market when compared to countries at similar development stages such as Argentina, Mexico, and South Korea. This graph illustrates the continued growth potential of the light vehicle fleet in Brazil.

Finally, in the bottom table, we'd like to show and clarify some of the doubts that I have mentioned. And the key question is that I have marked on hash is, how come after cycle volume continues to grow while a number of license light vehicle falls? Well, taking the final fleet of 2013 as a reference, we simulate it what would be the fleet growth if the number of new vehicles would fall.

We ended 2013 with 3.6 million new cars and a fleet of 37 million units. Scrapping was approximately 3.6% of the fleet. So, if we take a case where new car sales would fall by 20%, we would have 2.9 million new cars. Adding these 2.9 million cars to the final fleet of 2013 and deducting the same scrapping level of 3.6%, we would reach a final fleet of 38.5 million, which represents an average growth of 5% over the prior year.

Repeating the calculation for a 60% drop in car sales, in other words in a situation where only 1.4 million cars would be sold as opposed to last year 3.6 million cars, we would still have a small growth of 0.2 in the final fleet and an average growth of the fleet of 3% in the year. Therefore, it would be necessary a cumulative reduction of over 60% in car sales to see the feedstock line. This dynamic combined with our strategy of network expansion and differentiation with more convenience and services collaborates to our confidence in Ipiranga's continued growth.

Moving to Oxitenó in Slide number 6; specialty chemical sales in Brazil decreased by 3%, mainly due to the typical process of the inventory adjustment of our customers when the economy is reducing its level of growth as evidenced by the research published by the Central Bank.

We saw a reduction in almost all segments served by Oxitenó, except for home and personal care, which is characterized by its strong resilience. Specialty chemical sales outside of Brazil were down by 10% due to the lower operating level in Venezuela since the beginning of 2014, as a result of the limitations in importing raw materials in the country as we have already discussed with you last quarter.

Total glycol sales dropped by 25%, a significant percentage variation, but that is not uncommon for this product. As the commodity, glycols usually show high volatility in prices and demand. This leads to variations in the attractiveness of its sales and the market conditions were more attractive in the first half of last year than first half of this year.

The fact that the weaker real compared to the second quarter of last year was positive for Oxitenó, on the other hand, the real to dollar rate remained stable during the second quarter of this year, while the real depreciated significantly during the second quarter of last year, declining therefore a very positive effect for Oxitenó at that time, given the time lag between the FX rate implied in our revenues and that tax rate implied in our costs.

EBITDA reached 98 million in the second half of the year, down 8% when compared to last year, mainly influenced by the destocking process in the Brazilian market and the raw material limitations in Venezuela. EBITDA margin reached \$232 per ton.

Considering a stable exchange rate environment, the reduction in the operating level in Venezuela, since the beginning of the year and their facts of destocking this in the value chain in Brazil, the trends for the third quarter we saw EBITDA in the same level of the one that we had on the second quarter.

Now moving to Ultragaz in Slide 7, just like the fact we had in Ipiranga, we saw in Ultragaz, the reduction of two working days in volumes adding to the lower demand in the industrial segment. Due to such effects, sales volume in the second quarter was 1% lower than last year. These effects were partially offset by investment made to capture new customers mainly on the residential condos and small and medium businesses leading to an improved sales mix.

We had another quarter with the initiatives to reduce expenses showed results in Ultragaz. As you can see in the chart in the center of the page, Ultragaz's operating expenses were down by 5%. On the other hand, as anticipated in the last conference call, we continue our re-qualification progress with a bigger number of LPG bottles re-qualified in the quarter, which resulted in an additional costs of R\$9 million.

Ultragaz's EBITDA in the second quarter remained stable compared to the same period of previous year and totaled 73 million. Such result is due to the scheduled re-qualification of the LPG bottles and the 1% decrease in sales volume and inflation effects, which were offset by the commercial and expense reduction initiatives.

Excluding the estimated effect of 9 million with the added re-qualification, Ultragaz's EBITDA would have grown by 12% as compared to the second quarter of last year. And for this quarter, given that vast majority of that problem is now finished, the trend is that the grow at the same pace of the normalized EBITDA between second quarters.

Now let's talk about Ultracargo, our business of liquid bulk storage on Slide number 8. In this quarter, Ultracargo's average storage remained practically stable compared to the second quarter of 2013. We have seen in this quarter the continuing growth in the consumption [ph] of fuel oil for thermoelectric plants and fuels for vehicles as the result of the growth in these segments.

The growth was neutralized by lower handling in chemicals, which I also comment in relation to Oxiten's performance. EBITDA reached 43 million, a 2% increase compared to last year, mainly due to the improved mix of products handled with increased turnover of products, partially offset by higher maintenance expenses in the quarter. For the current quarter, the dynamic remains very similar and therefore trend that the evolution of the second quarter repeats itself in the third quarter.

Moving on now to Slide number 9 to discuss our retail pharmacy business, Extrafarma. During the first half of the year, we reached the final stage of the integration of

Extrafarma and continued restructuring of the company for a more accelerated growth, which is in absolute line with the plan that we have for the period of the acquisition. Among the steps implemented since February, we highlight, the centralization in the corporate center of treasury, accounting, accounts payable, legal, insurance and audit,

Second, establishment of a new urbanization structure with the creation of areas dedicated to the activities related to operations and expansions to allow greater specialization and agility in the process of opening stores. Third, the location of managers and analysts from Ultrapar and its businesses to Extrafarma in order to strengthen its team and facilitate the process of functional and control integration.

Four, the implementation of the EVA as a mechanism of alignment incentive that we also used for all our businesses since the last decade. Fifth, the implementation of a program for training and cultural integration for Extrafarma leaders and particularly Sixth, improvements in operating IT systems, resulting in enhanced productivity and controls, and finally we have advanced on the detailing of the working plan to enable accelerated drug store openings from late 2014 onwards.

With regard to the operations, Extrafarma ended June with 203 stores in the north and northeast regions of Brazil, a 13% increase or 23 stores when compared to the end of the second quarter of 2013. The increase of drugstores revenues with more than 12 months or so called same store sales, the 6% in the period, resulting in a 15% increase in total revenues together with the growth and numbers of stores.

The good revenue growth of Extrafarma was partially offset by the World Cup events. Since we had increased number of holidays in the period, particularly in the locations where Extrafarma is focused. In the same comparison, the number of drugstore of Extrafarma associated companies increased by 9% before our 13% comparing favorably to the 9% of industry and associated companies of Extrafarma had sales increasing by 11% while ours increased by 15.

Due to the integration of Ultrapar and restructuring of Extrafarma for a more accelerated growth, we had additional expenses of 6 million in the quarter. Extrafarma's EBITDA in the second quarter totaled 14 million or 21 million, excluding the expenses with integration and restructuring, a 5% increase compared to last year. Such growth is due to the increase in revenues, partially offset by three factors. First, the facts related to the World Cup; second, the great number of stores opened less than one year ago and of course still in maturing process, and third, above inflation increase in unit personnel costs.

For the third quarter, we currently see an operating environment similar to the second quarter, which leads to an expectation of an EBITDA on a standalone basis without the additional expenses of restructuring and integration in a similar level of that of the second quarter.

Moving to the final slide, I'd like to share something with you that we expect for the future, how we look throughout businesses beyond a single quarter. We try to break down in the slide, our businesses in two major groups. On the left, we list them as the main

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aspects of our business that have a more direct influence of the Brazilian GDP. On the right side, we list aspects where other drivers are more important. The product (inaudible)Ipiranga, nearly half of our volume corresponds to sales of (Technical Difficulty), which follows GDP growth of Brazil at a multiple of 1.7 points. On the other hand, the growth of the other half consisting primarily of gasoline and ethanol is influenced by fleet growth as I have showed you on Slide 5 and has an outlook of continued growth, huge effect of the behavior of the Brazilian GDP. And Oxiteno specialty chemicals in the Brazilian market, which represents 59% of our volume have grown at a multiple of 1.8 times GDP.

On the other hand, in our other part of our businesses were Brazil GDP is not a key factor. In Oxiteno the exports, international units and already known influence of the real and dollar exchange rate. In Ultragaz, we have the volumes sold in the bulk segment more directly linked to the Brazilian economic growth, since we basically serve commercial service businesses and industry.

Again, at the other hand, the volume of bottled LPG is virtually inelastic to the volatility of the economy and it's more influenced by the growth of the population. At Ultracargo, good economic activity normally means, an increasing handling of products and in the case of weaker economic activity, historical products have a better performance.

Finally now in new retail pharmacy business, the main drivers of growth are very resilient. With aging of population, inevitable phenomenon in Brazil for next decades influences the growth of medicine sales. The growing penetration of generic drugs also contributes to the growth of the pharmaceutical market since it increases the access to medicines to relatively price reduction.

And additionally, the sale of home and personal care products, increasingly common in pharmacies has grown independently of the evolution of the economy. The combination of our businesses characteristics, the way we position and manage them as well as our corporate governance, planning, and execution capabilities and acquisitions all have produced very consistent and positive results over the years.

I mentioned, we completed eight years of quarterly EBITDA growth. Looking at a broader perspective, we have 62 quarters of annual comparison to our life as a public company since the IPO in '99. We have EBITDA growth in 52 out of these 62 quarters. Having undergone significant market volatility not only from economic growth, but also adverse conditions in exchange rate, unemployment, income and et cetera. The combination of attributes and our track record allow us to look forward with optimism even in a more challenging macroeconomic environment.

I conclude here what we had prepared for today and now available for any possible questions you may have.

Operator

The okay.

Questions And Answers

Operator

Thank you. The floor is now open for questions. (Operator Instructions) The first question comes from Frank McGann with Bank of America Merrill Lynch. Please go ahead.

Q - Frank McGann {BIO 1499014 <GO>}

Hi, good afternoon. Just two questions, if I may; one is just in terms of inflation, I was wondering how you see this influencing your business over the next year say and in terms of cost and profitability and whether that's having any material effect on you and how you try to deal with that?

And secondly, in terms of Extrafarma, the outlook that you see for growth now say versus when you purchased it, I'm not thinking over the next three quarters, I'm just thinking overtime, how are you seeing that business now compared to when you bought it and what is your strategy here, how are you thinking of the mix of business between standalone stores and putting stores and service stations?

A - Andre Covre {BIO 15233513 <GO>}

Thank you. I'm very pleased with your question. Thanks for joining us. On inflation, on the recent months, the inflation has been touching the limits of the upper boundary of inflation target and it's therefore obviously of course are concerned. Inflation from our standpoint is never good and we deal with it over time, particularly because we have businesses some of them that our retail in nature and therefore any inflation is to be reflected in our profitability projections. So there's always two ways to deal with it, one is to get more efficient and the other one is to deal with it in prices. We try to use both instruments to deal with it and we have had meaningful inflation on the last several years.

We do not see a change in the characteristics of the market since we acquired Ipiranga, Extrafarma, the outlook for growth remains the same, the attractiveness remains the same, consolidation remains a possibility. I'd say, the only change that we are more enthusiastic about it, because we are now deep down into developing our plans and things are becoming very, very tangible and starting on the fourth quarter or beginning of next year, we're going to start opening more stores.

Q - Frank McGann {BIO 1499014 <GO>}

Okay. And in terms of just the mix of business between standalone stores and putting stores and service stations, any thoughts on that?

A - Andre Covre {BIO 15233513 <GO>}

We are in the midst of that. We don't have a fixed percentage and I don't think there will ever be a fixed percentage, because it will always be driven by the attractiveness of the location from a customer standpoint and availability of space. So it might be that in a certain city, we believe we should open let's say just for the example ten drug stores and

our sites are good for five and we are going to open five in our sites and five outside of our site.

So it might be in other cities where that's not five that's three or eight. So it vary a lot depending on the location of our gas stations and our Ultragaz LPG shops.

Q - Frank McGann {BIO 1499014 <GO>}

Okay, great, thank you very much.

Operator

The next question comes from Christian Audi with Santander. Please go ahead.

Q - Christian Audi {BIO 1825501 <GO>}

Andre, a couple of follow-ups. As you look out on the competitive level at the Extrafarma sector, can you talk about two things; one, how you see the competitive dynamics particularly as it relates to foreign companies potentially entering the Brazilian markets and secondly what's your stand from a M&A point of view clearly as you've explained before 2014, is a kind of preparatory year for the growth that come in the coming years, but if we were to see M&A activity this year, particularly among the larger players, is this something you would look at notwithstanding that you will always maintain a very good capital discipline. How is your appetite if M&A poor to become more active in the shorter term, although, I would think ideally you prefer that to happen later on.

A - Andre Covre {BIO 15233513 <GO>}

We see the potential arrival of foreign companies in Brazil on balance, positive. Tracing a parallel what we have in the fuels market, we do have today one major foreign company than we had in the past others and we believe that that will help foster a healthy competitive environment in reduction to degrees of informality.

You are correct that in terms of M&A activity for us this year, it's not a priority, but we are actively monitoring anything that is happening in the market and we will get involved with the typical financial discipline as you have mentioned if it is necessary and/or attractive.

Q - Christian Audi {BIO 1825501 <GO>}

Okay, thanks. And the second question, looking broadly at all your businesses as you look at the second half of the year, correct me if I'm wrong, both from a seasonality point of view, it should be a stronger half, but also from a number of holidays or fewer days, if you look at the second half of 2014, versus 2013, should we have a more attractive dynamic in this respect as well?

A - Andre Covre {BIO 15233513 <GO>}

You are right. Typically, the second half of the year has a bigger portion of EBITDA in profits of the year than the first half and we don't expect that to be different this year. The case of Oxiteno, the exchange rate is moving in the exact of positive of last year, we had

a significant devaluation during the third quarter and we are more or less stable, the value effect, the comparison for Oxitenó.

But other than this that you are correct with the profits because of seasonality.

Q - Christian Audi {BIO 1825501 <GO>}

Thanks.

Operator

(Operator Instructions) As there are no further questions, this concludes the question-and-answer section. At this time, I would like to turn the floor back to Mr. Andre Covre for any closing remarks.

A - Andre Covre {BIO 15233513 <GO>}

I'd like to thank you for your presence again. We are pleased to publish the results in line with our expectation. From a quarter as anticipated to have certain one-off events that is now behind us and the trends in the businesses that we are having are more clearly visible on the third quarter. So we look forward to being with you again, we have result in line with expectations we get. Thank you very much.

Operator

Thank you. This concludes today's Ultrapar's 2Q14 results conference call. You may disconnect your lines at this time.

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