Q2 2010 Earnings Call

Company Participants

- Andre Covre, CFO & IRO

Other Participants

- Michael Holm, Analyst
- Ricardo Cavanagh, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to Ultrapar's 2Q '10 Results Conference Call. There is also a simultaneous webcast that may be accessed through Ultrapar's website at www.ultra.com.br/ir, where the presentation is available for download. 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 a 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 question and answer 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 the 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 pleasure to be here with you to present another quarter of significant growth in our results. Before we proceed to the discussion of the results, I would like to draw your attention to slide number three, where we inform the criteria adopted for the financial information included in this presentation as well as the effect of the acquisition of Texaco and the divestment of Ultracargo's road transportation in-house logistics and solid bulk storage businesses.

With that in mind, moving onto slide four, in this quarter, we reported volume and growth -- volume and EBITDA growth in all of our businesses segments, reaching our 16th straight quarter of growth in Ultrapar's EBITDA. In other words, we're celebrating today four consecutive years of quarterly year-over-year growth in Ultrapar's EBITDA.

And I remind you that this long period of growth has occurred through different economic cycles, including the most critical period of the financial crisis at the end of 2008 and beginning of 2009.

On the other hand, in the first two quarters of 2010, with strong performance in the Brazilian economy, we presented one of the highest growth and results in the last several years, showing once more that Ultrapar has strong performance during periods of economic stability as well as in periods of accelerated growth of the economy.

Such solid sustained evolution of results is a consequence of the consistent strategic planning and execution, materialized through a position with strong returns and implementation of operational excellence progress.

Ultrapar's EBITDA amounted to BRL433 million, a strong growth of 35% over Second Quarter 2009. We reported record net earnings of BRL196 million, more than double the profits that we had in the Second Quarter of 2009. And this is due to the EBITDA growth in all our businesses and the lower financial expenses as a result of the process of deleveraging that has been following since we acquired Texaco. Net debt to last 12 months EBITDA decreased from two times at the end of Second Quarter 2009 to 1.5 times at the end of the Second Quarter 2010.

I also call your attention to the BRL177 million dividend payment approved, which is higher than the dividends that we paid in relation to the second half of 2009, following the evolution in net earnings. This dividend corresponds to a little more than 50% of the profits of the first half, therefore more than 50% payout, and represents an annualized dividend yield of 3% over the average price of the shares during the first half of the year, which is similar to the dividend yield that we had last year.

Moving onto the performance of each business, let's start with Ipiranga in slide number five. Well first of all, from this quarter onwards, we are able to analyze Ipiranga's results in a directly comparable basis as the Second Quarter of last year was the First Quarter that we consolidated Texaco.

So in this quarter, we had another strong positive evolution in sales volume with an 8% growth compared to the Second Quarter of '09, boosted by diesel volume, which increased by 11% due to the higher level of economic activity. Sales volume of fuels for light vehicles known as Otto cycle increased by 4% on the back of the continued growth of vehicle fleet in Brazil.

In relation to the financial performance, Ipiranga reported EBITDA total BRL236 million, 37% higher than the Second Quarter of 2009, basically as a result of three factors, first, the 8% growth in sales volume, second, the implementation of the Texaco operational and administrative synergy plan and lastly, the lower nonrecurring experiences -- expenses with the Texaco integration.

We had, therefore, another very good quarter, having the process of integration of Texaco being essentially concluded. We benefit in the results and reduction in the transitory integration expenses.

Ipiranga's unit EBITDA margin, excluding nonrecurring items related to the integration process, presented a BRL5 per cubic meter growth over Second Quarter 2009 due to the synergies and gains resulted from the consolidation of Texaco, which we have been experiencing and working on for the last 12 months.

On the other hand, the margin -- the EBITDA margin -- in the Second Quarter of 2010 was slightly lower than First Quarter of 2010. As usual, I must highlight to you not to focus on the margin of a single quarter as an indication of future as some occasional variations may occur.

In this case, in this quarter, the reduction in margin in relation to the First Quarter reflects the volatility in the ethanol availability in the market during the first six months of the year. The most pronounced effect we had was the migration of consumers from ethanol to gasoline during the First Quarter of 2010 and the reverse effect during the Second Quarter of 2010.

Such volatility in the ethanol availability also resulted in acute variation in prices. And as all fuels are to a certain extent interrelated, we had some effect in Ipiranga as a whole as well. For Third Quarter of this year, we expect the maintenance of the recent trends of the Second Quarter with an outlook for volume an EBITDA growth.

Proceeding now to slide six, let's talk about Oxiteno, which presented a quarter of very significant evolution in its results. First, in volumes, Oxiteno continued to present a very robust volume growth. In the Second Quarter, volume grew by 10% over last year's Second Quarter with sales of specialty chemicals increasing by 15%.

Domestic sales increased by 18% as a result of the higher level of economic activity and its effects on the sales of specialty chemicals, which historically grow at a multiple to the growth for GDP. Such volume growth was obviously enabled by the expansions in the production capacity carried out by Oxiteno during the last few years.

Now in this quarter, in addition to the repeated good operational performance in terms of volume, Oxiteno accelerated its margin recovery process, which is due to basically three factors. First, Oxiteno's enhanced its sales mix, both in terms of product with an increased share of specialty chemicals, but also its geographical mix with a faster growth in the domestic market, as you can see on the left -- top left corner of the slide.

Second and not less important were the commercial initiatives implemented by Oxiteno during the last few months in terms of market and pricing. And last but not least, the recent stability in raw material prices contributed to the picture. And all of this enabled Oxiteno to demonstrate its earnings potential.

These effects combined resulted in an EBITDA of BRL71 million for the quarter, BRL142 million -- I'm sorry, 142% higher than the Second Quarter of '09. As a consequence, unit EBITDA reached $224 per ton. And it's worth mentioning that the strong evolution in results occurred in spite of the much stronger real during the Second Quarter of 2010.

Still in relation to the Second Quarter of '09, you might recall that Oxiteno's EBITDA had been negatively affected by BRL35 million derived from the realization of inventory with historical costs higher than the replacement cost at that time. Even if we exclude this one-off effect from the Second Quarter of '09 EBITDA, Oxiteno's EBITDA would have increased by 10% compared to the Second Quarter of '09 in spite of the 14% stronger real.

Now for the current quarter, the outlook remains very positive. We expect Oxiteno's specialty chemicals and domestic market volume growth or sales volume to grow between 5% to 10% on a year-over-year basis, even considering that we're comparing with a very strong performance in volumes of the Third Quarter of '09.

And considering the recent stability in raw materials, we expect at this moment that the EBITDA margin in dollars per ton to be similar to the one of the Second Quarter of 2010, so a continuation of the same level of EBITDA margins in dollars, again, even with the stronger real that we experienced.

Moving onto Ultragaz on slide seven, sales volume amounted to 407,000 tons, 2% higher than Second Quarter of '09, boosted by a 4% growth in the bulk segment on the back of higher level of activity and economy and a recovery in industrial activity. Volume in the bottled segment remained steady in the period. As you probably recall, the sales of bottled segment have a very tenuous relation with the economy. So when the economy grows, it stays relatively stable. When the economy does not perform well, as it was in some moments of last year, it doesn't change much neither.

In relation to our financial performance at Ultragaz, we presented a 13% growth in EBITDA as a consequence of the realization of additional benefits from the operational efficiency programs and the good performance on the bulk segment. The unit EBITDA reached BRL205 per ton, BRL21 per ton higher than Second Quarter of '09.

For the current quarter, our expectations are of volume growth similar to the one we've seen on the Second Quarter, similar to the one we've seen between Second Quarters, and EBITDA margin per ton similar to the recent level of the last couple months.

Last but not least, Ultracargo on slide eight, as it happened in all other businesses, Ultracargo had an important volume growth. Its average effective storage was 14% higher than Second Quarter of '09 due to the consolidation of the acquired terminal in Suape and a higher volume of operations in the Aratu terminal on the back of the expansion that we just completed. Such growth was partially offset by a reduction in the handling of ethanol as a result of the reduced availability of this product to the export market.

Ultracargo's EBITDA reached BRL28 million in the quarter, slightly higher than Second Quarter of '09. The increased volume in the operations of the terminals and the realization of synergies resulting from the Uniao Terminais integration were partially offset by Ultracargo's decision to reduce its presence in some segments of the road transportation business during the last 12 months. As announced and as you probably know, on July 1st, we concluded the sale of the road transportation business. And therefore, this was the last quarter it was consolidated into Ultracargo's results.

For the current quarter, we expect a growth of EBITDA in relation to the Third Quarter of 2009 despite the sale of the road transportation in-house logistics and solid bulk storage businesses, reflecting basically the volume growth in the storage for liquid bulk business.

Moving now to slide nine, I'd like to take a moment to talk a little bit more about Ultracargo or as we call the new Ultracargo now exclusively focused on storage for liquid bulk. Ultracargo has a leading position in the storage for liquid bulk segment in Brazil, allowing it to have an outstanding operational scale. In addition, Ultracargo has a nationwide coverage with assets strategically located in the major ports of the country, which is an important competitive edge in its market.

With the sale of the road transportation in-house logistics and solid bulk storage businesses that I just mentioned, Ultracargo now has its management 100% focused on the storage for liquid bulk, a focus that leads to increased expertise in the services provided and intensify the search for new business opportunities in the sector.

In the last five years, the storage for liquid bulk segment grew at an annual average rate of 8%, considerably higher than the average economy growth rate of 4% in the period. Ultracargo on the other side grew by 12% per year if we consider only its organic expansions and 24% if you consider its acquisitions.

These are therefore the foundations for Ultracargo's growth, a market that grows leveraged on the GDP. We have assets that are very strategically located with a vast operation of scale in the market and with a management exclusively focused on its activities.

The Company is therefore very well positioned to capture the benefits of the positive outlook for the sector, especially increasing demand for logistics infrastructure in Brazil in order to meet the strong growth in the exports flow or equally important, in the imports flow, particularly of liquid chemicals, which strongly grows as the Brazilian economy expands. As a consequence of all of this, we have several expansion projects underway or to be started. And our strategy also includes opportunities arising from the consolidation process in the sector.

Moving onto the last slide and looking at Ultrapar's outlook in the longer term, I believe we are in the beginning of the upward trajectory of capturing the benefits arising from the maturing process of the investments carried out. In other words, we're now in the part of the investment curve, where EBITDA growth and financial results declined as the leverage that we undertook to make the investments declined with the cash flow generation. Therefore, only because of that, we can expect continuation on the EBITDA growth and a much more meaningful continuation in the growth of net profits.

In addition, the positive outlook for volume growth in fuels consumption, in specialty chemicals and in the storage for liquid bulk, all segments that grow faster than the GDP and in some cases at a multiple of GDP, allow us very good perspectives for the future. As you know, our businesses are well positioned to capture such volume growth with consequent increase in profitability to engage [ph] the scale in our operations.

Lastly, we will continue to actively seek investment opportunities in all our businesses, both through organic investments and acquisitions. We have a track record of investments that create a value and have strong returns. And with the same discipline, we will keep seeking opportunities there and reinforce our strategy of sustained growth.

Well this is what we had prepared for you today. I'm now available with the controlling directors of our four businesses as well as the financial team to answer any questions you might have.

Questions And Answers

Operator

Thank you. The floor is now open for questions. (Operator Instructions). Your first question comes from the line of Ricardo Cavanagh with Raymond James.

Q - Ricardo Cavanagh {BIO 1702523 <GO>}

Yes. Well hi, everybody. And congratulations on the results that were really strong. My question is regarding Ipiranga, basically how -- if you cannot bid on the targets in terms of EBITDA per cubic meter, how further up can it go from these levels not worth such [ph] improved significantly already? That would be one question.

And the second one was -- through your presentation, it's pretty clear that you want to prioritize growth but also wanted to ask if on the dividend front on -- if you are -- besides the dividend announcement that you made now, if there is a plan to increase the payout or the idea would be just to maintain the practice of the Company so far? That would be it basically.

A - Andre Covre {BIO 15233513 <GO>}

Thank you, Ricardo. Thanks for attending the call. In relation to Ipiranga, I understood your question was how much more can we grow the EBITDA margin of Ipiranga. As you have heard a moment ago, we do have a temporary situation in the market on the next couple months in relation to ethanol, which is pressuring markets. Having said that, we have no reason or element to believe our medium-long-term outlook for margin has changed.

And what drives that improvement in EBITDA margin is basically three factors. It's the pace of growth in the market, which allows us to capture more volume and with it benefit from operating leverage. In other words, profitability in a growing market tends to grow faster than volume growth.

Second, as I know you're aware, there is a -- still a meaningful degree of tax evasion and product adulteration in the sales of ethanol in Brazil. And as the level of informality is reduced, you benefit both from volumes but more importantly with this case, margins get aligned to correct levels, normal levels, as basically people that have artificially low costs are driven out of the market.

And last but not least, an important element of potential margin expansion is the enhancing of the product offering that Ipiranga has. As you might recall, it is the model of Ipiranga to offer a group of differentiated products and services in the gas station so that the customer has a more attractive retail experience. The owner of the gas station benefits from additional revenue streams. And Ipiranga benefits from a stronger profitability. As we manage to launch new products and enhance that marketing offering, we pave the way for increasing margins as well for us and for the entire chain.

In relation to dividend, the dividend at this quarter basically followed the evolution in profits that we had between first half of the year and the second half of last year and maintained the dividend yield that we have had for a number of years. The way we make our decisions in relation to dividend is to judge at every decision point if we have meaningful acquisitions or projects that may come our way or may materialize.

If we believe there's a chance of that happening, then we believe there is a good reason to maintain the level of cash with us. If we don't think nothing will come in the medium term, then what we have done normally in the past it make -- is made much bigger dividend payments. And over the last ten years of publicly listed company of Ultra, we've done that three times. It was in 2003. It was in 2005 -- sorry, 2001, 2005, and 2006. So nothing has changed in the way we view the dividends. It is the same framework. But it is applied to the situations that we face every time we are at a decision point.

Q - Ricardo Cavanagh {BIO 1702523 <GO>}

Okay. Excellent. Well thank you. Thank you, again, so much.

Operator

Your next question comes from the line of Michael Holm with Ultima.

Q - Michael Holm {BIO 17572380 <GO>}

Andre. Good morning. Congratulations on another set of very good results. I have two questions. One is regarding Ipiranga. I'm just curious to know if it's fair to say or not that the efficiencies that you expected to realize from the integration of Texaco have been fully realized or not. So that's my first question.

And the second question on Oxiteno, which has seen a very significant turnaround -- should we look -- assuming that there's no further changes on naphtha prices and on the exchange rate and I realize those are very significant assumptions but can we think about this level of margins as being sustainable for that part of your business? Thank you.

A - Andre Covre {BIO 15233513 <GO>}

Thanks, Michael. Good to have you with us. In relation to Texaco, the integration plan has been essentially finalized. What we have left is a small number of gas stations in the south Brazil that still need to be converted and all of the gas stations in the north of Brazil that still need to be converted to the Ipiranga model, as we can only do that starting April 2012. You might recall that at the time of the acquisition of Ipiranga, we licensed the Ipiranga brand for five years to be our -- for them to do the transition process.

Q - Michael Holm {BIO 17572380 <GO>}

Right.

A - Andre Covre {BIO 15233513 <GO>}

But other than that, it's essentially done. Now in relation to Oxiteno, you have heard from me -- and other analysts I think have heard repeatedly from me -- that once the expansions that we undertook in the last several years would be all up and running that Oxiteno should present an important improvement in its profitability, basically because the expansions all produce -- are all in -- are all the types of brownfields, so in existing sites, and are all focused on the so-called specialty chemicals.

The level that we have reached on the Second Quarter is consistent with the expectations that we had. And therefore, with assumption of naphtha and FX that you made, these are the beginning -- at least we see as the beginning of Oxiteno realizing its full potential.

Q - Michael Holm {BIO 17572380 <GO>}

Okay. Very good. Thank you.

Operator

(Operator Instructions).

A - Andre Covre {BIO 15233513 <GO>}

I have a written question that came from the webcast. It comes from Brian Strait [ph], an individual investor. Brian's question is -- I'd like to know if the declared interest rate of the 99% to CDI for the BRL900 million loan includes all costs related to this operation. If so, how can Ultra hire loans with interest rates lower than the ones available to Brazilian banks? And if not, what are the other fees or taxes included? And this additional cost accounted at -- is this additional cost accounted at the time of hiring or during the payment of a loan?

The interest rate on the loan is indeed 99%. Loans of this nature in Brazil are subject to a tax called IOF. If one factors the IOF into the cost, we are slightly above 100% of the CDI, which is the base rate we're borrowing and lending between banks in Brazil. We are able to obtain loans at such attractive cost because Ultrapar has a very good credit rating with a track record of strong cash flow generation and therefore provides for a safe harbor for most banks to lend to us.

The additional costs of the loan, which is basically the IOF, is paid at the time of hiring to the government. And in accordance to the accounting rules, it's part of the cost of the loan over time.

Operator

(Operator Instructions). This concludes the question and answer session. 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>}

Well thank you very much. It's been an honor and a pleasure to have you with us again this time. I would like to finish mentioning that what comes after the 16th quarter of growth in results is normally the 17th quarter of consecutive annual results or annual-quarterly results. So I look forward to seeing you in a couple months when we discuss the results of the Third Quarter. Thank you very much.

Operator

Thank you. This concludes today's conference call. You may now disconnect.