Q3 2017 Earnings Call

Company Participants

- AndrÃ© Pires de Oliveira Dias, Chief Financial & IR Officer and Member of Executive Board

Other Participants

- Felipe Dos Santos, Research Analyst
- Luiz Carvalho, Director and Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to Ultrapar's Third 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 and MZiQ platform. Please feel free to flip through the slides during the conference call.

Today with us, we have Mr. AndrÃ© 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. (Operator Instructions) A replay of this call will be available for 1 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. Pires. Mr. Pires, you may begin the conference.

AndrÃ© Pires de Oliveira Dias

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

Moving on to Slide #3. I would like to open our presentation today by discussing the performance of our businesses, starting with Ipiranga. Since last year, Ipiranga has prepared itself to accelerate its expansion by adjusting structures and establishing a solid pipeline of opportunities for converting unbranded service stations to its network as well as opening new ones. This allowed us to increase investment in the business and grow Ipiranga's network. In order to continue investing at this accelerated pace, we have approved additional CapEx of BRL 355 million for 2017. And allocated the BRL 123 million CapEx that would have been deployed in Ale's network if the acquisition had been completed.

In the end of September, we have 7,814 service stations, a growth of 6% year-on-year. Ipiranga added 420 service stations net over the last 12 months, 251 in September year-to-date. And 71 in the Third Quarter of 2017 alone. The benefits of this expansion will be progressively seen as the network matures. In addition, up until September of 2017, we also opened this year 138 am/pm convenience stores together with 87 Jet Oil franchises and 90 bakeries. These investments enhance Ipiranga's strategy of constant innovation in service and convenience, helping to increase the flow at the station, customer satisfaction and loyalty as well as providing an additional source of revenue and differentiated position for Ipiranga resellers.

Sales volume in the Third Quarter grew by 2% compared with the Third Quarter of 2016, a return to the year-on-year growth after various quarters of decline. The factors driving growth in volumes were gradual recovery in the economy, improved levels of income and employment. And accelerated expansion in the network since the end of last year. Sales in the Otto cycle segment rose by 2% year-on-year, with an increased share of gasoline in the product mix. Diesel sales were up by 3%, again, in line with the gradual recovery in the economy as a whole and the improved performance of the wholesale segments.

During the course of the Third Quarter, we began to experience a new fuel pricing system introduced in early July, with daily adjustments in refinery prices. As such, we have been working with prices that are closer to international benchmarks. Also from a cost standpoint, we saw an increase in the PIS/COFINS taxes in -- on fuels announced in July.

Looking at our expenses, part of the growth is connected to our decision to sign up to a special tax renegotiation program conducted by the Brazilian government, covering same situations where we had ongoing losses and discretions. Additional expenses also resulted from some strategic initiatives taken during the period, such as the constitutional for joint venture with Chevron lubricants. EBITDA increased by 21% compared with the same quarter of last year, mainly reflecting the growth in volumes and one-off inventory effects due to the variation in fuel costs.

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, orders of magnitude and trends in results. As previously mentioned, the performance of the second half of 2017 has been improving over the first half, even though the competitive environment remains challenging. Ipiranga will continue to accelerate its organic expansion and ramp up new service station openings. This strategy is expected to have a positive impact on volumes for 2018, allowing Ipiranga to keep the positive growth in its results.

Moving now to Oxiteno in Slide #4. Oxiteno reached record sales volume this quarter with growth in sales of both specialty chemicals and commodities. If we break down this growth, volumes of specialty chemicals in Brazil increased by 3% year-on-year. This was the fifth consecutive quarter of growth reflecting the development of new products and solutions for our clients, in addition to the gradual recovery in the Brazilian economy. The highlights were volumes to the distribution, automotive fluids. And home and personal care segments. Growth in international market was 1%, mainly due to the result of increased volumes in the U.S. on the back of premarketing sales for our Pasadena plant in Texas, currently under construction. Commodities volume increased by 21% year-on-year, reflecting favorable conditions both in price and demand for the products. As I mentioned at the last conference call in August, 2 effects had a more prominent impact on results for the Second Quarter. And these effects remained during the Third Quarter. Volatility in raw material prices continued to squeeze margins, leading to inventory losses due to the sharp decline in palm kernel oil prices. Furthermore, in the Second Quarter, we experienced technical problems in starting the oleo-chemicals plant following its scheduled stoppage, problems that were already solved. These effects combined had a negative impact of BRL 26 million on the Third Quarter results. In addition to this specific event, the foreign exchange rate, the real was 3% stronger than the U.S. dollar year-on-year.

Oxiteno reported an EBITDA of BRL 74 million in the Third Quarter of 2017, which is a decline of 25% from the Third Quarter of 2016. If we exclude the nonrecurring effects of BRL 26 million, I just mentioned, then we would have reached an EBITDA of BRL 100 million, in line with the Third Quarter of 2016.

Looking forward to the next months and the year of 2018, the trend is for continuing growth in volume, both due to the economic recovery in Brazil and to the stand-up -- the start-up of the new ethoxylation plant in the U.S. next year. It's worth remembering that some external indicators have shown considerable volatility over the past two years. If we assume a degree of stability in these indicators and considering the growth in volumes on which we have already commented, we expect to see a positive trend in Oxiteno's results for 2018.

Moving on now to Ultragaz in Slide #5. In the Third Quarter of 2017, Ultragaz sales volume reached 460,000 tons, a decline of 1% compared to the same period of 2016. This was mainly due to a drop in bulk sales volume, mainly due to the increased volumes sold to industrial clients in the Third Quarter of 2016 and the loss of some clients that switched to natural gas in the Third Quarter of 2017. The volume in the bottled segment increased by 1% due to investments for attracting new resellers. The impact of price increases in the international markets were reflected in the domestic market from June 2017 onwards, affecting the bulk and bottled segments. On the cost side, Ultragaz is continually seeking to improve productivity and reported reductions in freight, LPG bottle requalification and maintenance costs in the Third Quarter of 2017. Additionally, in the Third Quarter of 2016, we recorded an outlay of BRL 50 million in our marketing company, which was not repeated this quarter. Therefore, Ultragaz EBITDA amounted to BRL 157 million in the

Third Quarter of 2017, a 46% growth compared to the Third Quarter of 2016, due to a reduction in cost and expenses, together with commercial initiatives for adding new clients and resellers as well as the differentiation strategy based on innovation.

Our outlook for the coming months and for 2018 is for continuous growth in results. Our short-term focus continues to be on the approval process of the LiquigÃ¡s acquisition.

Let's now move on to Slide #6 and talk about Ultracargo, our liquid bulk storage business. Ultracargo's average storage increased by 7% compared with the Third Quarter of 2016. This was largely due to increased fuel handling activity at its terminals in Suape, Itaqui and Santos, the latter as a result of the partial resumption of the operations at the Santos terminal in June. The average capacity utilization in the Third Quarter was 93%, even considering the capacity still unavailable at the Santos terminal, which advances Ultracargo's improved productivity. Ultracargo posted EBITDA of BRL 40 million in the Third Quarter of 2017, a 72% year-on-year increase mainly due to the greater fuel handling activity, increased productivity in all terminals and then the partial return of its operations at the Santos terminal. We continued to see growth in the demand for liquid bulk storage, particularly in the fuel sector, given the current supply dynamics in the Brazilian markets. In this context, Ultracargo's focus will be on efforts to expand capacity and to use the company's leadership position as a growth lever to achieve even more positive results in 2018.

Let's move on now to Slide #7. And talk about our retail pharmacy business, Extrafarma. Extrafarma ended the September 2017 with 366 drugstores, an increase of 25% over the 293 drugstores as of September 2016. At the end of the quarter, 51% of the stores had been operating for less than three years compared with 43% at the end of the Third Quarter of 2016. During the Third Quarter this year, we opened 30 stores and in the last 12 months, 88. Third quarter gross revenues at Extrafarma rose by 16% year-on-year, as a result of an 18% increase in retail sales due to a greater average number of stores and a 7% increase in same-store sales.

In the same period, market data from Abrafarma shows a sector-wide increase in revenues of 9%, an indication of Extrafarma's outperformance compared to the market as a whole. Third quarter EBITDA amounted to BRL 7 million, an year-on-year growth of 10%. This was principally due to the growth in retail sales as well as strategic and commercial initiatives for raising management standards in the retail pharmacy network, notably in the productivity gains and trade marketing, partially offset by a larger number of still maturing stores. We continued to seek the goal to open 100 stores this year. We ended the Third Quarter at the rate of 30 stores per quarter and the expectation for the Fourth Quarter is to open an even larger number. This will put us in a position to further accelerate store opening base next year. The gradual maturing of the stores will lead us to an EBITDA growth of -- in 2018.

Moving on now to Slide #8, to talk about the consolidated figures of Ultrapar. And before closing this presentation, I'd like to reinforce some points which supports our expectations for the performance of our businesses.

As we have already mentioned, the Second Quarter was atypical and the outlook is more positive for the second half with greater stability in the business environment. We have already seen improvement on various fronts in the Third Quarter with year-on-year growth of 20% in EBITDA and 46% in net income. We have seen several indications of improvement, whether it's in economic scenario or to our team's excellence in executing the strategy. Volumes at Ipiranga are resuming its growth due to an improvement in the economic scenario and our only initiatives in accelerating the expansion process. The maturing of the service stations will bring increasing benefits to our volumes and consequently, to our results. Oxiteno posted record volumes for single quarter, while the domestic sales of specialty chemicals has been growing for 5 consecutive quarters. And we still have the new ethoxylation plant in the U.S. to come on stream in 2018. In addition, Ultracargo's operating flexibility in maximizing the business opportunities arising from greater fuel handling activities, the opportunities for growth in the LPG bottled and bulk markets at Ultragaz. And our accelerated growth strategy at Extrafarma are also important components for our growth outlook. Lastly, following inflation and the resulting decrease in the Brazilian basic interest rate will continue to benefit our bottom line, together with the reduction in the cost of debt, measured in percentage of CDI. In addition to the proven capacity of our teams to execute our business plans, these factors inspire confidence in the continuous growth of our businesses.

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

Questions And Answers

Operator

(Operator Instructions) The first question comes from Felipe Santos with JPMorgan.

Q - Felipe Dos Santos {BIO 16391255 <GO>}

In the -- again, you've spoken during the Portuguese call, just to further understand more clearly, the -- in the call, in the Portuguese call, there was a question saying about the size of the additional gas stations. And we have seen especially in the big cities of Brazil these additional gas stations have been connected with smaller gas stations. Are you seeing the same kind of trend throughout the rest of the countries, especially (inaudible) where you invest more? Or do you think that there's still a sizeable number of gas stations bigger with good proportionate -- bigger volume. So the EBITDA expands? Or we are reaching like a limit of those bigger gas stations not being there anymore and just like now they are (inaudible) to put meter and smaller gas stations to be converted?

A - AndrÃ© Pires de Oliveira Dias

Felipe, thanks for your question. Felipe, it's exactly the opposite. What is being seen in terms of opportunities for the pipeline that Ipiranga is pursuing is normally gas stations at higher throughput than the average throughput that Ipiranga has in its network. Now the strategy -- the expansion strategy that Ipiranga is undertaking is, obviously, a combination, in some cases, of a fragmented conversion of some individual gas stations, eventually gas stations with higher throughput. But also looking for opportunities to brand a network of unbranded gas stations as well. So we've seen a lot of interesting opportunities of white-flag network of 10, 15, 20, 25 gas stations that are being branded into Ipiranga's brand. So in general, the trend that we are seeing is quite the opposite. It's a trend of pursuing gas stations with higher throughput than our average. And in fact, as I mentioned during the morning call, obviously, we normally report these numbers as a number of gas stations. But the focus is much more in terms of the volume contracted or volume added to our network that could be eventually even higher with a lower number of gas stations. So this is very important. And the focus is looking for gas stations with higher throughput. Obviously, you don't have the potential throughput of these gas stations right at day 1, right? There is a maturity process or maturity period. And they reach their -- let's say, their peak normally after 12 to 18 months after being opened.

Q - Felipe Dos Santos {BIO 16391255 <GO>}

That's great. Then one follow-up question. Would you consider start releasing the -- some sort of breakdown of number of gas stations by volume. So we could increase or update and do better estimates for our forecast? Saying the target would be to increase these number of gas stations in volumes that we have bigger volumes. Then like we have like the kind of opening that we have in Extrafarma?

A - AndrÃ© Pires de Oliveira Dias

Felipe, I'm not sure I understood. It would be practically impossible that we -- I mean, we're talking about opening in this particular case (inaudible).

Q - Felipe Dos Santos {BIO 16391255 <GO>}

Yes, opening (inaudible) number of gas stations by volume, not like a range. Or do we think this could be doubled? And we could see business strategy, the application and enforcement of diesel structure to do throughout the quarters?

A - AndrÃ© Pires de Oliveira Dias

No -- well, we'll have to check. But I don't think it's viable to do that, because in the end, I mean, you're opening gas stations, the volumes are not fully maturing in the year that you open the gas stations itself -- themselves. Then you would have to wait for 12 to 18 months until you have this information. Obviously, over time, we're going to have the volume that Ipiranga has. You're going to have the growth and volume that Ipiranga has. You're going to have the growth of -- the volume growth of the market. And you would be able to assess if the strategy is working or not. If you look at the volume and the number of gas stations, obviously, on average, you would be able to assess if the strategy of opening gas stations with higher throughput is actually happening or not, all right? But I think it's very difficult to disclose this. There is 1 station per station, there are too many stations, all right? If you think about it.

Operator

The next question comes from Luiz Carvalho with UBS.

Q - Luiz Carvalho {BIO 18040760 <GO>}

Just 2 quick questions. The first one regarding Oxiteno. You have the plant, then in U.S. coming -- looking forward. And we saw better margin, something over the second -- the Third Quarter, sorry. Just would like to understand how do you see the spreads going forward and in terms of getting to the profitability of the business? The second question, it's a follow-up from the question that I made on the -- today on the Portuguese call. You had a very aggressive, let's say, CapEx plan, mainly for Ipiranga. And when I aggressive, compared to the other companies that we have access to the information. And so far, despite that, you accelerate, let's say, CapEx -- the CapEx disbursement, we haven't seen, let's say -- or at least we're expecting to see a larger number of gas stations. So I just would like to understand if there is something about, let's say, the branding process that would take more time? Or there's some, I'm going to say, inertia in the beginning of the process? My real question is, how can we, how can I say, try to forecast? Or how can we try to understand what would be, let's say, the number of gas stations added by -- I don't know, by the couple quarters?

A - AndrÃ© Pires de Oliveira Dias

Thanks, Luiz. Hello, again. Well starting for Oxiteno, well, basically, as I mentioned in the call, we are assuming the completion of the construction of the plant throughout the First Quarter of 2018. This will bring, obviously, better volumes and better results for Oxiteno as a whole. In addition to that, we've been seeing a consistent increase in volumes for Oxiteno, 5 quarters in a row, especially for specialty chemicals in the domestic market. We've seen some one-off impacts starting to, in a way, fade away from the results of Oxiteno, if you look at, specifically, the PKO inventory adjustment as a inventory loss. This should be over by the Fourth Quarter already. So if we see a certain stability in its indicators, then we can expect a positive EBITDA growth for Oxiteno in 2018. An improvement in terms of profitability, especially if you consider that one of its main raw material, the PKO is back to more normal levels in terms of price, which is positive for margins as well. So we see good prospects for Oxiteno looking towards 2018. Coming back on the question on Ipiranga's CapEx. I mean, a few things that you have to take into consideration. First of all, the additional budget -- the additional CapEx budget that was informed

(technical difficulty)

Q - Luiz Carvalho {BIO 18040760 <GO>}

Hello?

Operator

We appear to have lost audio from the main speaker's location.

(technical difficulty)

I've rejoined the speakers on the backup line.

Q - Luiz Carvalho {BIO 18040760 <GO>}

AndrÃ©, are you there?

(technical difficulty)

Operator

We've reconnected to the speaker's location.

A - AndrÃ© Pires de Oliveira Dias

Hello?

Operator

Yes. Your line is open, Mr. Pires.

A - AndrÃ© Pires de Oliveira Dias

Okay. Well I was answering a question. I don't know if my full answer was heard. Luiz, are you there?

Operator

Luiz, your line is open.

Q - Luiz Carvalho {BIO 18040760 <GO>}

Okay. AndrÃ©, sorry about that. You were starting to answer the second question regarding -- you said the number of gas stations. You said there are 2 things the additional budget that was informed or signed. And then cut the line.

A - AndrÃ© Pires de Oliveira Dias

Okay. So I'll start over to answer your question on top for additional CapEx for Ipiranga. So basically, you have to keep in mind that the approval of this additional budget happened in mid-September by the board, right? So you do not deploy capital immediately right after you have the approval of this additional budget. But nevertheless, you're going to see a significant pace of new gas stations or branding of unbranded gas stations throughout the Fourth Quarter and throughout 2018. Very hard to be precise on the number. But it's going to be significantly higher than the Third Quarter of 2017. Again, we have to take into consideration the timing effect, which is the approval of this additional budget that happened by mid-September. In addition to that and the decision of this strategy to accelerate the expansion process was taken and proposed after the end of the (inaudible) preceding the

(technical difficulty)

previously which happened early August. So those things take some time. But independency of the timing in fact and what we can say looking forward is the accelerating the pace, which is going to be able to be seen in the Fourth Quarter of 2017 and throughout 2018 as well.

Operator

(Operator Instructions) Showing no further 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 - AndrÃ© Pires de Oliveira Dias

Thank you very much. And I hope to talk to you again when we release our Fourth Quarter results next February. Thank you very much. Bye-bye.

Operator

(technical difficulty)

Today's Ultrapar's 3 quarter -- Third Quarter 2017 results conference call. You may disconnect your lines at this time.