

Q1 2016 Earnings Call

Company Participants

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

Other Participants

- Andre Natal, Analyst
- Frank McGann, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time we would like to welcome everyone to Ultrapar's First Quarter '16 Results Conference Call. There is also 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 Pires, Chief Financial and Investor Relations Officer, together with other executives of Ultrapar.

We would like 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 results to differ materially from those expressed in such forward-looking statements.

Now, I'd like to turn the conference call over to Pires. Mr. Pires, please begin your conference.

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

Thank you. Good morning, everyone. It's a great pleasure to be here with you to discuss Ultrapar's performance in the first quarter of 2016. Here with me to help answering your questions, I have my colleagues from our businesses and Investors Relations team.

Starting with slide number three, I would like to start our presentation by an overview of the quarter which was once again very positive, improved the resilience of our multi-business model even in an increasingly challenging environment. The decline in GDP, which has been causing an unemployment to rise and real income to decrease while inflation rates remains stubbornly high, demanded our management team's intense dedication to act against the negative effects.

In this scenario, Ultrapar's net revenues amounted to BRL20 million in the first quarter of 2016, growing by 12% over the first quarter of '16. Consolidated EBITDA grew by 7% in the same comparison basis to BRL1.1 billion. Net earnings remained stable on a year-on-year basis, mainly as a result of high interest rates and net debt.

We maintained our CapEx plan reaching BRL292 million in the quarter, concentrating our initiatives towards diversification of our products and services providing greater customer convenience and satisfaction, and increasing our scale. We plan to invest 1.8 billion this year, reinforcing our confidence in strengthening the company to projects that add value to our shareholders.

We have been growing EBITDA by 39 quarters in a row on a year-on-year basis. This consistent growth that was followed by a return on equity of 19% and the maintenance of a strong balance sheet, a key characteristic that has been present for many years. The net debt-to-EBITDA ratio remained within its historical levels at 1.5 times. It is important to highlight that due to the seasonality of our businesses, the working capital needs in the first quarters are normally strong.

Moving on now to slide number four, we will comment in more detail the performance of our businesses, starting with Ipiranga. Ipiranga's volume in the first quarter of 2016 was 3% lower than the first quarter of '15, following the same trends in the fourth quarter of 2015. Sales volume for light vehicles fell 5% influenced by the sharp deterioration in unemployment rate, which reached 11% in the first quarter of 2016, compared to 8% in the same period of the previous year. Disposable income also worsened, decreasing 3% in real terms since January 2015. The adverse environment, which combined rising unemployment rate, with increasing prices for fuel had a stronger influence than the fleet growth on Otto cycle sales volume. The average fleet growth is estimated at around 2% for this year. Diesel volumes fell 1% compared to the first quarter of 2015, also as a result of the deterioration of the economy.

Even with the challenging economic scenario, Ipiranga is still reaping the benefits from its investments focusing on expanding and strengthening its network, as well as from strategy of differentiation. In addition, constant innovation in services and convenience, with customer satisfaction and loyalty helps to increase the flow at the service station.

FINAL

In order to keep strengthening the company and mitigating the effects of the current challenging economic scenario, Ipiranga continued focusing on the expansion of its service station network. By the end of March 2016, Ipiranga had 7,241 service stations, a 3% growth over March 2015. It has been investing in converting unbranded service stations and opening new ones, focusing on the Midwest, Northeast and North of Brazil regions with a larger growth potential due to the lower penetration of vehicles. In addition, we've added 204 new am/pm stores which are now present in 27% of the Ipiranga service stations, increasing the offer of services to our customers.

On the net earnings side, it is worth mentioning that that we had same one-off effects throughout the quarters. Performance in the first quarter of '16 benefited from the combined effect of the temporary inventory gains and a concentration of sale of assets, amounting to BRL89 million. In addition, still in the first quarter of '15 [ph], the dynamics in the -- the dynamics observed in the domestic and international fuels market created an opportunity to import products, which blocked gains of BRL42 million last year. In the first quarter of '16, these opportunities were also present bringing equivalent gains to those seen in the first quarter of 2015.

The EBITDA net of these one-off effects grew by 40% compared to the first quarter of 2015, following the same trend observed in recent quarters reflecting the strategy of constant innovation and convenience in service station. Including the non-recurring effect, the reported EBITDA reached BRL712 million, stable on a year-on-year basis.

Looking now for the current quarter and talking about expectations, I would like to highlight that they are not specific projections, but rather trends, levels or order of magnitude of the progression in our results. In Ipiranga's case, the trends and the economic environment that influenced the last two quarters do not change and should remain for the second quarter. Therefore, our expectations for the current quarter is of a similar growth in volume and EBITDA compared to the last few quarters.

Now moving on to Oxiteno in number slide five, total sales volume at Oxiteno grew by 4% over the first quarter of 2015. The evolution was concentrated in the glycol segment, each as a commodity occasionally offers good opportunities to offset the effect of a more challenging economic scenario by contributing to fixed cost dilution. Sales volume of specialty chemicals fell 6% compared to the first quarter of 2015, influenced mainly by the strong contraction of the Brazilian economy, which was partially compensated by the growth in exports.

The 75% growth in glycol sales is a significant percentage change, which is not unusual in the case of this commodity as it was mentioned before. Such increase was driven mainly by more attractive raw material prices as a result of the 36% average oil price drop on a year-on-year basis. The decision to produce more commodities in the current scenario reinforces our strategy to seek better capacity utilization rates and cost dilution of the plants, while specialty chemicals sales in Brazil are hit by the weak performance of the economy.

FINAL

The 37% depreciation of the real against the US dollar contributed to a very positive results progression of -- at Oxiteno, together with the overall sales volume growth. These effects were partially offset by a larger share of commodity in the sales mix resulting in BRL198 million of EBITDA, a 37% growth over the first quarter of 2015. For the current quarter we expect that the challenging economic scenario should continue to influence sales volume and the sales mix; this increasing participation of commodities driving average margins. Additionally, it is important to highlight that the volatility of the effects normally impacts Oxiteno's results.

Moving now to Ultragaz on slide number six, in the first quarter of 2016 Ultragaz sales volume grew by 1% over the first quarter of 2015. In the bottled segment, which is usually very resilient during challenging scenarios, our volume grew by 1% due to the commercial initiatives to add new retailers. In the bulk segment we reported a performance similar to that in the first quarter of 2015. In that segment we outperformed the market due to the initiatives to capture new customers mainly in the condominiums and small, medium businesses segment and also to initiatives towards some industrial clients mitigating the negative effect of the economic slowdown.

In the first quarter of 2016, Ultragaz EBITDA reached BRL109, a 50% increase over the first quarter of 2015. This achievement is a result of the initiatives to increase the overall [ph] convenience and satisfaction to its customers and the addition of new clients plus the culture of strict control of its fixed costs. For the current quarter even in this challenging macroeconomic environment, we expect results at similar levels to those presented in the last few quarters due to the resilient nature of the Ultragaz businesses and its ongoing commercial initiatives.

Now, let's talk about our liquid bulk storage business Ultracargo, moving on to slide number seven. Ultracargo's average storage excluding Santos operation increased by 6% compared to the first quarter of 2015 mainly due to the stronger volume of fuel handling, while the handling of chemicals declined reflecting the weak economic activities.

Ultracargo's total average storage decreased by 13%, basically explained by the partial interruption of the Santos terminal due to fire that occurred in April of last year. In the first quarter of 2016, Ultracargo's EBITDA excluding Santos operations reached BRL26 million in line with the first quarter of 2015, when we also exclude Santos. Reported EBITDA reached BRL33 million in the first quarter of 2016, a 32% reduction compared to the first quarter of '15 mainly due to the partial interruption of the Santos terminal and fire related expenses, which was partially offset by insurance reimbursements.

Throughout the first quarter, we had BRL30 million of revenue from insurance reimbursement, which were related to certain containment and recovery expenses incurred in 2015. We also had expenses from a fine in the amount of BRL60 million paid to the State Environment Authority and had an additional BRL8 million of expenses related to the second phase of the decommissioning process.

For the current quarter, the trend recently observed for the terminals excluding Santos earnings [ph]. Regarding Santos we should continue to report expenses related to the

FINAL

second phase of the decommissioning process and revenues from insurance at the same level we reported in the first quarter.

Before moving to Extrafarma, I'd like to make a brief update about the Ultracargo's operations in Santos. In February, Ultracargo obtained approvals by the authorities and started the second phase of the decommissioning plan, which constitutes in removing the equipment and structures damaged by the fire. We expect to conclude this phase by August. During this work, experts of the Criminalistics Institute will conclude the report determining the causes of the accident. We expect the recovery work of the damaged areas to take place during the second semester. Terminal should be ready for operational licensing by the end of this year.

Moving now to slide number eight, to discuss our retail pharmacy business, Extrafarma. Extrafarma entered the first quarter of '16 with 261 stores, an increase of 35 -- sorry, an increase of 35 drugstores compared to March 2015. Seven stores were opened during the quarter. In April, continuing the process of capturing synergies among Ultra's businesses, Extrafarma opened its first drugstore in an Ultragaz reseller in Fortaleza, state of Ceara.

Extrafarma's gross revenues increased by 10% compared to the first quarter of 2015, mainly due to the 16% increase in retail revenues, excluding mobile phones, resulting from the growth in average number of drugstores and the 12% increase in same-store sales, despite the deterioration of the economic scenario and the decline of the real disposable income.

In the first quarter of 2016, Extrafarma's EBITDA reached to BRL5 million, a slight increase compared to the first quarter of 2015, mainly due to the increase in revenues ex-mobile phones and initiatives to improve the management standards in the retail pharmacy network. This result was achieved despite the deterioration of the economic scenario and a higher share of new drugstores, still in the maturing process.

After a seasonally weaker first quarter, we are working with an estimated level of 20 new stores for the second quarter, which allows us to keep on track to open from 60 stores to 80 stores this year. The accelerated stores opening pace with the objective to gain market share from independent drugstores, continues to influence results since the deals maturing drugstores tends to impact on our EBITDA.

Now on slide number nine, to talk about our priorities and perspectives and to conclude our presentation, I'd like to reaffirm the priorities of our businesses, which have been pursuing ways to continue growing, even in more challenging scenario. Ultrapar's growth has been supported by our investments, which place us in a solid position to see market opportunities offered by the current economic environment. We're also prepared and strengthened us for the return of the economic growth. It is necessary to continue following our market's needs and keep the sense of opportunity, the analytical depth and the capital discipline that brought us here.

The beginning of this year was a demonstration of our team's capacity to react to difficulties in the challenging macroeconomic environment and we should continue in this

path to report one more year of growth in 2016.

Now with that, I conclude my part of the presentation. I now open for the Q&A session.

Questions And Answers

Operator

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

Q - Frank McGann {BIO 1499014 <GO>}

Yeah. Hello, good afternoon. Yeah, just a couple of questions if I could. One, in terms of Ultragaz, the results were quite strong, and that's on top of what was a fairly strong quarter in the prior year. I was wondering if you could give maybe, a few more details on the commercial initiatives and how that enables you to get what looks like, you know, very, very strong leverage from additional sales.

Secondly, with a potential economic recovery at some point, timing I guess, remains to be seen, where do you think you're going to have the most leverage and how are you preparing for what could be a pick-up at some point over the next one to two years?

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

Okay. Hi, Frank. Thanks for the question. The first one regarding the Ultragaz commercial initiatives. I think, in many segments, I think, because that has been very successful in a way, compensating or mitigating declining markets by being able to capture new customers and new segment. If we look at the bottle segment, is basically the focus on opening new resellers or looking for new resellers throughout the country. But more specifically, in the bulk segment that has a more, I'd say, strong correlation with economic activity. Ultragaz has been very successful in penetrating into small and medium businesses, which in a way to suffer less in a scenario like that as opposed to let's say, large industrial clients. And even in large industrial clients, so in the other piece [ph] applications that Ultragaz has been able to develop, kind of created for Ultragaz, a new entrance in market that were before eventually only available for natural gas. So same technology that has been implemented as well, they have been in a way, allowing Ultragaz to compensate for a very weak, let's say, market for the bulk segment.

As for the potential economic recovery and who knows, like I mean, it's something that is very difficult for us to predict, but we believe that the fact that we have a strong balance sheet and the fact that we are always looking at opportunities, will allow us to be prepared and ready. It's not a question of if the trend -- the economy starts to recover.

And I think pretty much in all segments of reals [ph], specifically segments that are linked to the Brazilian GDP, so we can talk about Ipiranga, we talk about Ultragaz, which we just mentioned already, you mean, and Extrafarma as well, segments that are linked to the consumption and we believe that we are very well positioned when the economy starts to

recover, on those two businesses, on the other businesses as well, but those are the ones that have a more, I would say, strong correlation with domestic consumption.

Oxiteno also does have this correlation, but has other, let's say, variables, like the foreign exchange rate, like commodity prices. So they are more, I'd say more indicators for Oxiteno as opposed to other three that are more linked to overall economic activity. And Ultracargo, you know, as well would benefit from the recovery in the economic activity.

Q - Frank McGann {BIO 1499014 <GO>}

In terms of demand, are you seeing any changes in trends in the second quarter for better or for worse? Are they continuing more or less in the same level in terms of demand in -- at Ipiranga, demand in some of the other segments?

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

More or less at the same levels, Frank. I think, whatever expectations eventually start to improve is, is from now on. I mean, when we look at -- what would we see today as compared to the first quarter, we are -- or it compares as well to the fourth quarter of '15, we are pretty much at the same levels.

Q - Frank McGann {BIO 1499014 <GO>}

Okay. And if I could just one more, in terms of Santos, what you're expecting in terms of potential insurance recoveries over the next several quarters, if any? And when you get to restarting up the facility there, what -- how much incremental volumes would that imply and what would be the comparison of where you expect to be in terms of capacity there, versus where you were prior to the fire?

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

Yes. We -- if you know, I mean, if you look at our balance sheet, I mean, there has been an increase in our assets and also an increase in our liabilities, which pretty much in the same magnitude. I think it's BRL140 million for the assets and BRL110 million in the liabilities, which in a way is already a testament of the expectation that we had in terms of our obligations at work -- our obligations from now on, and expectations that we have regarding the receivables of insurance from now on. So 112 million of, let's say, assets and 110 million of obligations from here on. So this is something that we expect that has already been included in our balance sheet.

As for, let's say, the Santos terminal, once we conclude, then we have all the final authorization from, let's say, all the authorities and we start, let's say, remodeling and rebuilding the portion of the terminal, but it is still interrupted. We believe that we should start operating there by the beginning of 2017. Then at present all is starting, then probably we will deal with a capacity close to 95% of the capacity that we had before the fire. So there is a portion of this capacity that probably do not comeback in line.

Q - Frank McGann {BIO 1499014 <GO>}

Okay. Great. Thank you very much.

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

Welcome.

Operator

Our next question comes from Andre Natal from Credit Suisse. Please go ahead with your question.

Q - Andre Natal {BIO 19547370 <GO>}

Hi guys. Thank you for taking our questions again, while you just mentioned about GDP, I just wanted to go back to that a bit if I may, a little bit more specific on diesel. We've seen that in the last five years or so prior to 2015, of course, we've seen diesel consumption actually increasing above GDP growth rates instead of, you know, the more long historical trend that had been prior to that GDP actually grew pretty much in line with consumption, diesel consumption growth.

So of course, this recent increase might have been boosted by, you know, in Santos to trucks fleet expansion and also boost in agriculture production, especially in the Midwest region, where you are basically trying to focus now. But looking ahead, I wanted to, you know, I was wondering how do you guys think about it, when you do your longer-term investment plans and things like this, how do you guys think about the long-term prospects of diesel consumption growing going forward assuming the country at some point in the future will resume growth. How do you think about diesel consumption growing, is it, you know, do you expect it to keep in line with GDP or do you see a -- you know, a period of accommodation in which basically diesel could grow lower -- at a lower rate than GDP for a while, how do you -- how should I think about it?

And just connected to this one, there is a -- there are investments expected to happen in the Midwest region to increase capacity of existing railroads and this might, you know, capture a bigger share of transport of crop, especially soy and corn towards the southeast ports. So I just wanted to know, how do you -- if that this is something you guys are following, you know, very closely and if you have any ability to give us a hint of how relevant this might be to diesel volumes in coming years?

And the other one, if I may, is concerning the branding strategy that you have in the, you know, the North, Northeast and Midwest regions. The strategy we've seen, although, you know, there is very limited reliable data about the exact number of stations especially for white flags. But with, you know, based on what we have, we have basically seen that your sales per service station has actually been decreasing for the last five years a bit. I know this is not a, you know, a particular objective you have in terms of, you know, the volumes per station.

But I just wanted to understand, if this result is basically a consequence of your strategy of branding stations that basically have a lower volume than Ipiranga's average stations in the region and if this might, you know, revert at some point in the future when, you know, after branding these service stations start to, you know, sell more as a, you know, consequence of the branding process? Thank you.

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

Andre, let me try to address your points here. Starting with diesel, basically we continue to have the conviction that the correlation that we have for diesel volumes related to GDP growth. Obviously you have some specific effects in the short term that do not necessarily follow this trend, but over the long term this is what we should continue to absorb.

If you take the first quarter of 2016, we outperformed the market in general, because we don't sell to the, you know, thermal electric plants, and as you know, the thermal electric plants has shut down most of them, they are not operating due to the fact that demand of electricity in Brazil is relatively very low and ideologically quite in a way have been solved at least for the short-term. But if you exclude those one-off effect, the trends over the future continues to be a correlation towards the GDP growth.

As for the branding strategy, and if I understood correctly your point, and in sometimes if you look at the comparison, which should be similar to same-store sales, you could see eventually some volumes, especially, you know, recently dropping. And the reason for that is, obviously the expansion of our network and the fact that, when you add a new service station, when you brand unbranded service stations, it takes some time. There is a ramp-up for the volumes to start migrating towards a more extended level for Ipiranga. And even when we open a new one, obviously there is a ramp-up phase for that.

So it is in a way a consequence of the expansion strategy that we have been having, obviously in the more, let's say, shorter-term, there is the impact of the overall economic activity. But the strategy to brand unbranded service stations remains and are especially, if it's possible, in the Northeast, North and Midwest. It's important to remember that if you take unbranded service station, they represent around 25% of the market. So there is still a large opportunity for us and for others as well to grow and brand [ph] this piece of the market.

Q - Andre Natal {BIO 19547370 <GO>}

Very clear. Thank you so much.

Operator

Ladies and gentlemen, this concludes today's question-and-answer session. At this time, I would like to turn the floor back over to Mr. Pires for any closing remarks.

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

Thank you. Thank you everyone. Thanks for participating in the call and I hope to see you all again back during our call for the second quarter of '16 in August. Thank you very much.

Operator

Thank you. This concludes today's Ultrapar's first quarter '16 results conference call. You may now disconnect your lines at this time.

FINAL

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.

Bloomberg Transcript