Q2 2021 Earnings Call

Company Participants

- Andre Correa Natal, Chief Financial, Procurement and Investor Relations Officer
- Wilson Ferreira, Chief Executive Officer

Other Participants

- Analyst
- Andre Hachem
- Bruno Montanari
- Luiz Carvalho
- Pedro Soares
- Regis Cardoso

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to the BR Distribuidora Second Quarter 2021 Earnings Conference Call and Webcast with analysts and investors. (Operator Instructions). Joining us today are Mr.Wilson Ferreira Junior, CEO; Mr.Andre Natal, CFO and IRO. We would like to remind you that this meeting is being recorded.

This presentation may contain forward-looking projections. These projections are the expectations of the company executives about future economic condition, in addition to the sector where we operate, the performance and financial results of the company, amongst other things. The terms predict, believe, expect, forecast, intend, plan, project, objective, should, and other such terms are used to identify such forward-looking statements which evidently involve risks and uncertainties seen or not seen by the company, and do not therefore provide an assurance as to the company's future results.

These future results may, therefore, differ from current expectations, and readers should not solely rely on the information set out herein. The company undertakes no obligation to update the projections in the light of new information or future development. The figures informed for 2019 onwards are estimates or targets.

Now, I hand the floor over to the CEO of BR Distribuidora, Mr.Wilson Ferreira Junior, who will deliver his presentation. The floor is your Mr.Ferreira Junior.

(Operator Instructions)

Can we start? Yes.

Wilson Ferreira {BIO 1528124 <GO>}

Yes.

Operator

Mr.Wilson, you have the floor.

Wilson Ferreira {BIO 1528124 <GO>}

I apologize to everyone. Good morning. I would like to thank you all for joining earnings conference call for the second quarter of 2021. I will start with a brief conversation -- brief presentation with nine slides. Let's just start with the first slide, with the highlights of the company for the second quarter of 2021.

We have an EBITDA of BRL 115 per cubic meter and we also achieved our lowest level of expenses of BRL 51 per cubic meter. We have also been expanding the number of service stations, 312 new service stations were added compared to the second quarter of 2020. And we also added 1.6% of point -- percentage points in market share compared to the second quarter of 2020.

Now, let's move on to the next slide. The most important event in the quarter was our fellow-on offer. This made BR Distribuidora a true corporation. Here, you can see the results of this work that changed these as of the second of August of 2021 1.165 billion shares is our total number of shares; 70,584 different shareholders and 2,621 funds; more than 50% of our base consists of long shareholders -- long-only shareholders and we have almost 68,000 individuals in our shareholder base. You can see the pie chart showing the number of individuals and global entities in our shareholder base as well as the domestic and foreign participation. 43% of our shares as in the hands of domestic shareholders and 57%, I'm sorry, 43% in foreign shareholders and 57% in domestic shareholders.

Our liquidity almost doubled reaching almost BRL 400 million per day. That was a very important transaction for BR Distribuidora and also very significant for Brazil and for Petrobras itself. On the right hand side, you can see that was the largest transaction in the capital market in 2021 with over BRL 23 billion of demand and 160 orders in our book. Petrobras was able to monetize BRL 11.4 billion with its participation of 37.5%. And you can see the evolution here in the chart showing how the BR Distribuidora has become a true corporation.

Now, I'm going to share the data for our quarter. First, we would like to reaffirm our commitment to becoming one of the most efficient companies in terms of expenses. We have had a decrease of almost 40% and expensive getting BRL 51 per cubic meter, compared to 2019, the year before the pandemic because that's a fair comparison considering all the events that happened in 2020 with the pandemic. Our EBITDA is BRL

115 per cubic meter, a 47% increase and our debt over leverage was 1.4x in the second quarter of 2021.

In the next slide you can see the data about market and BR's participation. In fuel and sales in April and May actually more April than May, we still suffered the impact of the second wave of the pandemic. So there was an increase of 20% compared to the second quarter of 2019 -- actually compared to the second quarter of 2020 and a 3% reduction compared to second quarter '19.

In terms of liquid fuel, BR recovered from 20 to 21, there was and 28% increase. But there was also a drop of 3% compared to 2019. In the last 12 months, there was an increase of 2% in the Brazilian market and 7% in the market served by BR Distribuidora. So BR Distribuidora has had a better performance here in this market. And here in the right hand side, you can see the months of April and May that the Brazilian market was hit heart, but there was an increase of 26% and the trajectory of BR's market share in the quarter. We went from in 26.9% in April to 29% in June. So we see important signs of recovery in the economy because of the vaccination rate and the economic recovery that the fuel market is keeping up with. BR Distribuidora has benefited from that growing in volumes and market share.

Now on the next slide. We see numbers of the market infected by COVID-19. We can see the Otto cycle diesel. In the chart we see that 2021 was better than 2020, but the months of April and May were worst than in 2019, which is the most important reference base that we have. Now, if we look at the BR total sales, including the month of July, we saw that the months of March, April and May were hardly heads.

In terms of seasonality, that's the lowest quarter of the year, but there was a great recovery in terms of total sales as well as market share. At the bottom of the slide, you can see the Otto cycle growing from April to July by 13%, actually, considering both Otto cycle and diesel. And the benefits that we shared with our -- follow-on with the greater thermal dispatch in Brazil, we have reached 350,000 cubic meters of fuel oil in June '21. Compared to the months of April and May, these numbers more than doubled.

Now, the same behavior can be seen in aviation. There was a 70% increase in market share. So a recovery in the aviation segment as well. So in terms of total numbers and in fuel, you see that our company is well-positioned and also for aviation that there were significant variations in our volumes as you can see.

Now in our next slide. You can see the main projects of the company. We talked about this during our follow-on offer. We have forecasted a reduction of BRL 250 million 2022 as additional reductions to be implemented in 2021. More than 200 action plans were established with more than 60% of them already complete with expected additional recurring savings of BRL 250 million.

Now, in terms of transportation. Our target is of BRL 90 million to be fully implemented in 2022. This is an expansion of the program started in 2019. We have implemented an optimization system called Control Tower using artificial intelligence and this is now being expended. 45% of the logistics railway network has already been covered. We have already captured BRL 10 million in savings. And by the end of the year, we expect to have the transportation of dark products, QAV chemicals, and non-wheeled forms to get to another -- to those BRL 90 million.

Now there are also some important aspects related to the package of retiring 250 assets in our property portfolio with a partner we selected at the final states due diligence and those partner will make an important action in this. We have made the direct sales of six stations amounting to BRL 29 million and we expect to sell another eight service stations in the third quarter.

In terms of logistic assets, we have identified 25 opportunities of optimization either through sharing, retirement or other types of negotiations. We have the potential generation of BRL 130 million by the end of 2021. And we already have one asset negotiator at around BRL 22 million of cash. ESGAS was also included in the privatization program by the government of the State of Espirito Santo with divestment earmarked by BR for 2022. With the set of actions, we'll have a BRL 640 million in additional annual EBITDA.

Now, on the next slide, you can see our trading. We had already seen in the market there is need to complement trading. And we are structuring ethanol trading company, which is near completion and also derivatives trading company which is near completion.

In terms of convenience stores, this process is being concluded at CADE and we understand that starting in September, we'll be able to have our joint venture with Americanas starting operations.

Lubricants, we have modernized our lubricant factory with an increase in 70% of the productive capacity. 80% of those modernization and expansion has already been completed. We are reformulating our sales channels, establishing authorized dealers, 25% of the schedule has now being completed and we're improving the sourcing of base stocks imported directly by BR. We also have partnerships with additive suppliers to add more than BRL120 million in 2022.

In terms of pension plans, we have a new plan structured and communicated to the workforce. It's being analyzed by PREVIC. We expect members to start joining in January 2022. This could bring us a potential reduction in actuarial liability that we currently have. With these eight measures that I have just shared with you, we can add around BRL 640 million additional annual EBITDA to be full achieved in 2022.

Now, on the next Slide, I would like to mention that in this quarter, we implemented two important actions. The first one, the approval of payout of interest on capital for our shareholders and that was in addition to the BRL 700 million, as already stated, that will be paid and the BRL 1.1 billion that was already paid this year. So we have been remunerating our shareholders strongly and working hard to maintain value creation considering the perspectives of company, the BRL 614 million in our share buyback program.

I would like to conclude by saying that in 16 weeks, we have been developing our strategic review and our ESG vision. We have had three workshops with all of the directors and executives of the company. We have Board of Directors taking part as well. We have reassessed the context and the scenario of our industry.

The second workshop focused on reformulating the strategy, detailing the main strategic portfolio choices, looking at BR of the future, and validating strategic paths. And 10 weeks ago, we concluded the reformulation of our strategy, defining our ESG vision and the changes to the organization and governance. Breaking down our micro indicators and targets, and we are now defining our equity story. And on BR Day 2021, on the 1st of September, we would like to share that with the market. We will have then the opportunity of sharing our long-term vision for BR with all of you.

I would like to thank you once again for joining us in our earnings conference call and together with Natal, we are now available for questions.

Questions And Answers

Operator

(Question And Answer)

Ladies and gentlemen, we shall now start our question-and-answer session. (Operator Instructions) Our first question is by Regis Cardoso from Credit Suisse. You have the floor, sir.

Q - Regis Cardoso {BIO 20098524 <GO>}

Hello, can you hear me?

A - Wilson Ferreira {BIO 1528124 <GO>}

Yes, we can hear you.

Q - Regis Cardoso {BIO 20098524 <GO>}

Thank you for taking my question and congratulations on your presentation. You were talking about the direct sales of ethanol. But I would like to hear from you about this broader regulatory discussion. The pertinent topic today within this context of changing their rules of sliding or service stations, do you have exclusivity clauses in your contract? And what are the effects that you expect from the direct sales of ethanol? In terms of collection of distribution taxes, and also the public consultation [ph] about the reduction of penalties in cases of fraud and service stations. And there was also something about removing one decimal from the prices in the pumps. Can you please tell us about these regulatory issues in broader way please?

A - Wilson Ferreira {BIO 1528124 <GO>}

Sure. I'll try to give you a broad overview on this, and then Natal and Henry, our Legal Director, can give you further information. This was an announcement that surprised all of us in the market. And it's probably happening as we speak. But in general, this process has been able to sell is something that can happen today, consumers have the option of buying from white flag or no trademark service stations, but the choice of consumers buying from these white flag stations is already possible, but BR is the network that grows the most because the talk of benefits that we offer to consumers. Consumers can rest assure about the quality of the product that's being sold in our service stations. There is a lot of confidence in terms of the quality of the products and services provided by our service station. You also have convenience, services available, loyalty programs. In all of that, not only fuel is something that's part of the value proposition and consumers are very sensitive to that and our goal is to offer a network that makes available to consumers, not only the best product, but also the best service and the confidence for consumers, when it comes to taxes and tariffs, but update and so on. This type of value proposition will create a new business model. It's very clear one and the relationship that we have with the dealers is a contractual relationship those is an option that dealers do a choice they make to offer to their consumers the differentiated value proposition in terms of quality of products and services. But this is a bilateral negotiation that is guided by a contract. With financial clauses that remain unchanged. If you look at the official data today, the difference in prices of fuel so by white flag service stations and trademarks stations was less than $0.01 last month and for Dingo less than $0.04.

So once again, those are the consumers' choice. They may choose to go to a white flag service station in order to save money. But that's not what they're choosing. They are choosing trademark services stations because they offer higher quality products and services, and of course, we respect all contracts that have been fined and they have been signed to guarantee the offer of products and services of high-quality. The services that we offer in the management of the network, we have a program surveillance of fuels to guarantee high quality of products offered to consumers. And of course, there will be a lot of debate about these provisional measures, which will only be put in force 90 days after the announcement with all of the debate that will happen in the Congress.

And for BR, we have a competitive edge because we have high quality of products and services offered. So we respect the contract and we'll keep the same growth perspective for our network. We intend to keep our network differentiated and completely set apart from other white flag services station. Natal, do you have any comments about the direct sales issue?

A - Andre Correa Natal {BIO 21073585 <GO>}

Good morning. Thank you for your question. I think Wilson mentioned the most important points already, but I'd like to draw your attention to the fact that we've been gaining traction in trademark services stations, we had an addition of 302 new services stations in the first half of the year. So our network is growing and we have been outperforming the market. And those link has happened, not because of legal obligation, but because there is a perception of value on the part of dealers and consumers. So dealers want to be connected to BR, it's about image, convenience, payments, and so on.

So this perception of value from the part of dealers is also based on the perception of values from consumers. Consumers, see the trademark. They know that it's high quality product, that is being offered. So we want to keep the line of contract along the same lines that we have had with exclusive contracts. So we don't think this is going to change and the law does not forbid that quality of flag, so it will probably not interfere in bilateral contracts about the direct sales. There has been many studies from the logistics perspective to understand the implications of that. But we understand that it doesn't make sense for most of the cases that the vast majority of cases except for very specific cases of a service station that is next by plant.

But from the logistic perspective, the operations today have much more scaler the ethanol create a base and then it will be transported in a smaller vehicles that will deliver both gasoline and ethanol. So when it comes to logistics we don't see any direct benefits for the price or costs of fields with the direct sales, we don't think that it's going to become a business that haven't the plants delivering fuel directly to the service stations, because it doesn't make sense from the logistics perspective.

Now, of course, in cases in which it makes sense, this can happen, but these will be only a few exceptions. And we're working for everyone to understand the tax implication. It is very important. Today, ICMS and PIS/COFINS is being addressed and provisional measure. But there are other taxes that are not being addressed and we need regulatory changes to make it extremely monocyclic or -- monocyclic at least in the cases in which the direct sales is happening.

In terms of delivering, we have no objections. This is something experimental. There is no scale yet and we don't know whether this is seen as a value by consumers. There might be a market niche, but we don't think this is going to be extremely relevant, at least in the foreseeable future. We always express our concern in terms of the safety of this type of supply. We have a whole set of licenses and inspections in service stations to guarantee safety during the delivery.

If you start making deliveries for households, you cannot make sure that this is going to happen with the right safety conditions in terms of emissions and other safety concerns, because we're talking about an inflammable product. So any type of measure addressed in that should take that into account.

Now in many countries around the world, they have businesses, that sell per liter. We have a strong opinion about that. But we don't see any relevant direct implication of that. We would think it would be best to keep it as it is because that's the practice in the sector. Consumers and dealers are used to that, and that is something widespread throughout the world as well. But that's not going to have direct impacts on our business as it is today.

A - Wilson Ferreira {BIO 1528124 <GO>}

I'd just like to add something, I'd like to remind you that this whole effort on the part of the government is to try and increase competition and to decrease prices. The expectation is that this will lead to price decreases. Now when we look at the price composition of fuels, we see that, we need to address this. The President's just insisted on reducing the tax burden, but we have around 9% to 10% effective ICMS to 7% into -- into 11% and on (inaudible) ICMS is almost 16%. And when we talk about logistics, guarantee of supply, origins and so on those impacts is not so great. So I think the concern here is about taxes.

Now, Natal has mentioned that direct sales, tax collection and monocyclic. This market has a lot of tax evasion, it was BRL24 billion last year alone. So greater efficiency in tax collection can also help us decrease the tax burden in the sales of fuel. And that would make the fuel more affordable for consumers.

Q - Regis Cardoso {BIO 20098524 <GO>}

That was very clear. Thank you for your complete answers.

A - Wilson Ferreira {BIO 1528124 <GO>}

Thank you very much. Thank you.

Operator

(Operator Instructions) Our next question is by Luiz Carvalho from UBS. You have the floor, sir.

Q - Luiz Carvalho {BIO 18040760 <GO>}

Hello Wilson. I had a few questions here. I think that your comments during this first question were great. But I would like to hear more about your buyback program. Can you do the buyback today already? That's my first question. After those conference call were those the enabled already? And my second question, this quarter we talked to many players, not only your main competitors and we've seen greater competition for volume.

Starting with industry players. Have you been able to sign a contract with a major player in the region of Campina with a rebate of almost $0.10 per liter, I mean, this is something we've heard about. So when we look at these numbers from other companies, it concerns me. The level of provision in your balance sheet about these contractual rebates, it seems to me that this rebate amount is growing a lot. So what is your take on that? On the rebate issue vis-a-vis short term volume sale.

A - Wilson Ferreira {BIO 1528124 <GO>}

Thank you, Luiz. I will start and maybe Natal can add to my answer. Yes, the buyback can already began with a limit of BRL1.5 million, where's a volume that has been established already. So this is being done to protect shareholders from any type of volatility. Up to one year, these are the values that will be used.

Now, about the competition. You're right. We cannot be enforced by the months of April and May because that's when we have the second wave of the pandemic and there was the volume reduction as we saw in the charts that I shared with you. When that happens, there is fiercer competition and pressure on prices. We have a business rationale is to grow creating value to our dealers. So of course, we try and do that with a lot of cautious using our PDI tools. Because we want to act correctly, I'm not aware of that rebate operations that you mentioned in Campinas that's not something that's part of our rationale. We are gaining market share, but our focus is always on business sustainability, because if you start with practices like that, you will impact your quality and credibility and that's not our strategy. Natal, do you have anything else to add?

A - Andre Correa Natal {BIO 21073585 <GO>}

So Luiz, you're right. Throughout the second quarter, we saw a few movements happening, but it was a quarter that was hardly hit by the pandemic, there was a significant reduction in volumes. In terms of seasonality, we would expect the second quarter to be stronger than the first quarter in terms of volume. So you would expect these seasonality to make these grow around 6%, and it did not grow even half of that. In the older cycle, that is more affected by mobility restrictions, you would expect a volume increase compared to the first quarter. But there was actually a decrease in the volume in the older cycle.

And Aviation is a very sensitive area when the pandemic gets worse. People don't want to get into airplanes and that has an impact on volumes as well, which is something that we felt. It was something around 23%. So when we see the market contracting, we expect players to become a bit more competitive, so to speak. They all want to compete for this decreasing volume. That's a natural trend.

But during our presentation, we showed you the evolution month-by-month. We were hardly hit in April, but in May, June and July, we saw an upward trend in all segments, auto is growing well, diesel is growing well, it was already expected to grow because of the seasonality that it was actually growing due to the lease and the lockdown measures and the aviation in June was 63% higher than in April. So it was indeed a challenging market and the second quarter and that affects everyone, it affects margins as well because the players wants to keep their positioning.

In June and July, we saw a reversal of that dynamic. The dynamic is more positive, not only in terms of volume generating economies of scale, but also a reposition margin that also entered this more positive dynamic. For dealers and consumers PRR or industrial for them it doesn't matter if you call this rebate or something else. What they want is a more competitive price. And we can offer discounts via rebate or via pricing. It doesn't matter which the that, that will not generate any type of provision. You use the term provisions, so we don't do any type of provision with this closed rebates, but we've been offering through our time in more competitive markets, the rebates tends to go up and the other way around in less competitive markets. But except from the situation, we went through in April, or May, we don't see a structural change in the market, in terms of more rebate.

When it comes to the service stations of our trademark, we've been trying to set the conditions beforehand and what matters the most is the total ROI of the operation that is a commercial and risk management strategy for those transactions, but we don't see a greater pressure for rebates. What we've seen is that in more competitive markets, you use this type of mechanism to become more competitive or to maintain competitiveness, but these are not structural or permanent area. Thank you so much.

Operator

Please hold while we solve some technical issues. Our next question is by Andre Hachem from Itau. You have the floor sir.

Q - Andre Hachem {BIO 20209966 <GO>}

Hello, Wilson and Andre. Thank you for taking my question. I'd like to talk about two issues. First, about ethanol, the market is very heated, the price is evolving. So I'd like to hear about your supply strategy for ethanol? And is there any chance that the government will reduce the numbers temporarily? And now about diesel. We've seen higher prices, but the government has lowered the prices. What do you expect from now on in terms of acquisition of biodiesel for the rest of the year? You know, about green coke. When we look at the major consumers there was negative effect of green coke, in fact, non-recurring factor. Now thinking abut he medium term horizon, how can you offset this negative coke effect? How can you supply the sales of green coke, and keep your results driver? Thank you.

A - Wilson Ferreira {BIO 1528124 <GO>}

I will ask Andre to answer these questions.

A - Andre Correa Natal {BIO 21073585 <GO>}

I just have an observation about fuel oil that you mentioned. Indeed, we've been going through a lot. The Ministry of Mines and Energy has been acting with the MPE

in a prudent way. And I believe that we're going to -- it's going to take us about two years to recover from that. In the medium term, we can expect that and we showed that in our presentation. There's also some gas limitation defined by -- and also fuel oil and diesel competitive when we look up the price of gas.

Q - Andre Hachem {BIO 20209966 <GO>}

But I'd like to hear from Natal, you also mentioned ethanol and when you look at the Otto cycle, you'll see an important addition, an important growth of gasoline consumption and an impact on ethanol volumes and biodiesel you have a very high value. And we see you have localized operations. If you open for imports, I'm sure that the prices would decrease. The reduction happened because of the aggressive price increases in biodiesel.

A - Wilson Ferreira {BIO 1528124 <GO>}

Now, I think Andre can give you further information about that.

A - Andre Correa Natal {BIO 21073585 <GO>}

Hello. Thank you for your question. Now, about ethanol, we have created a market intelligence area in order to better understand the price movements. In the beginning of the harvest this year, we have a typical movement with higher prices differently from what we usually see. Our strategy has been to anticipate purchases in order to create those inventory effects within the month. But the coke strategy as a whole hasn't changed much. What we want us to increase our focus on ethanol and we've been evolving a lot in fact, we've had significant gains and important share evolution linked to that. But about ethanol sourcing the trader is key, and we've been evolving a lot in that. We understand that the short position of distributor like ours with the long -- joined with the long position as a relevant player could create significant synergies in terms of possibilities for geographical carriers and arbitrage of different types. Also in the international market, and we also want to have greater scale for purchase and sales of ethanol, once we start operating and trading those commodity, considering the short position of BR and the long position of this company with whom we've have -- been having a close conversation. So that should change our competitiveness in terms of ethanol sourcing.

In terms of number changes, we haven't seen those discussion prosper for now. So we'll keep arrival at around 27%. So now about coke. As you know, we've talked about those in other conference calls, part of the volume of coke, Petrobras decided to sell directly to some clients. And the other part was sold through bidding processes and some of them we did not win. So we had the whole volume of coke, but now these contracts are expiring and now we need to compete with the market. Half of the market is out of hand because it's in direct sales or in biddings that were already completed and we can compete for the other 50% approximately. So we think we'll have a certain percentage, we wanted to become the more relevant -- as relevant as possible as those remaining volume, but it is much smaller volume than we used to have.

But that was our part of our business plan. All of the targets that we shared with you in other opportunities in terms of EBITDA growth and other prospects is for 2021 and had already presupposes thus, contraction of the coke market. The fuel oil market was not foreseen. We could not predict the water crisis we've been having, but that offset the impact. I would not say we were helped by that, but the oil fuel is only a partial mitigator during a pandemic when you have decrease of many products, of the sales of many products. So those oil fuel impact was good, but it did not assess the whole volume decrease that we had.

Looking ahead, this is something that this had only came in June. But we expect it to last till the end of the year, at least. And the consumption levels of oil fuel because of the impacts in June were already higher than in April and May. The levels of June and July that you saw in the charts that we shared with you are the levels that correspond to both additional demand that was unforeseen and compensated part of the coke effect that you mentioned, but the volume expansion will happen in spite of the coke reduction.

But it's not one single product that will be able to do that. We have ambitions for the rest of the year and for the following years, for us to recover part of this market. We believe the market will grow back again as the economy recovers. And we have expansions that earning expansions. Our earnings will expand because of different sources, and we've had the best second quarter and the history of our company. The first quarter, also had a very high EBITDA. And I think that, we've been able to neutralize the coke effect, neutralize more than offset the coke effect, but that's not for one single factor, but many factors.

A - Wilson Ferreira {BIO 1528124 <GO>}

I would just like to add a comment. The company has been strengthening because of new businesses like electrical energy. We have an extraordinary growth potential in the segment, because we now have consumers in the free market. And our results had also being -- has also been impacted by EBITDA coming from convenience. And on our BR day, we want to be able to share part of our vision for the future with all of you. We are now focusing on other fuels and other energy sources, considering all of these changes that we've seen in the market, including the oil field that you mentioned.

Q - Andre Hachem {BIO 20209966 <GO>}

Great. Thank you very much.

A - Wilson Ferreira {BIO 1528124 <GO>}

Thank you.

Operator

Our next question is by Bruno Montanari from Morgan Stanley. You have the floor, sir.

Q - Bruno Montanari {BIO 15389931 <GO>}

Good afternoon. Thank you for taking my question. I have a follow-up on the provisional measure. Has anyone expressed interest in installing white flag pump in your network, just so we have an idea of the movements that are happening? Now about trading margins, the second quarter was weird because of the pandemic and I would like to hear from you about whether you expect better margins in the trading market in the third quarter? And now about working capital, Looking at the last four quarters, you would say it is a whole EBITDA in terms of working capital. What do you expect for the next four quarters?

A - Wilson Ferreira {BIO 1528124 <GO>}

Okay, I'll turn the floor over to Natal. But, I will be honest with you, if you look at the perspective, it's not only about installing a white flag pump. But you have a significant additional investment to sell a product that will be cheaper or lower quality. So I don't think anyone would want to do that. Now considering the benefits for consumers it would be almost the same as going into a McDonald store and buying a cheese sandwich from another brand that's not going to happen. If you work with the brand, you incorporate attributes to the brand and consumers related to the product, related to the quality, the sourcing, the services, it's much more than just offering something cheap in a place where you sell standardized products. So I think that economically speaking, that's not going to be feasible, because it may cost more than your previous premises.

Now, in terms of margins, as you -- competition, becomes more reasonable then when you have a lower level of inventory and more competition. Now, all your fuel and diesel for using thermal electrical plant is another issue. Now, I'd like to turn the floor over to Natal to talk about the working capital question you asked.

A - Andre Correa Natal {BIO 21073585 <GO>}

Okay. Thank you. You talked about the margin and the second quarter as you well know, as physically speaking weaker than the first quarter in terms of margins. It's better in terms of volume, but it's worse in terms of margin. So the pandemic generated

these conditions and I'd like to establish a connection with the working capital that you asked, when you're in a pandemic and you have volume decreases, the sales estimates that affected inventory and other issues will actually affect our inventory levels that would be higher and with higher inventory levels. You have future competition and backward affect margins. So in addition to the scale effect that Wilson mentioned, there's also the reposition margin per se.

Although this is not your main question, in terms of recent margins. In the first quarter, we have had an important inventory gain and we share these numbers with you in the first quarter, and those inventory gain goes through the gross margins, only. And the gross margins alone, is therefore influenced by the gains or losses of inventory.

So in the first quarter, we have better dynamic. In terms of volume, it was before the second wave of the pandemic. And we had a very relevant inventory gain, with resales that were above BRL50 per cubic meter in the first quarter. And now we had a slight loss of inventory in resales almost BRL70 difference from one quarter to another. Just related to price variation and not margins per se. So this is related to the competitive dynamics. But once we see the volume recovering, those will be mitigated. If we look at the July numbers, we can see completely different margin dynamics not only the volume is much higher, but the margin will also reacting positively to that. And with regards to working capital, there is a bit more than BRL1 billion in inventory accumulation, I'd say that around 60% of that inventory is related to this drop in volume internally. We were not pre-supposing a pandemic. So when the pandemic hit, we have those inventory accumulation for most of the products we went to a higher bent of inventory.

Diesel was hardly affected by that and that accounts for about 60% of the whole variation, but the primary cost was the volume decrease, which is reloaded to this whole scenario. And there is also a price movement and I'd say that once we overcome that situation and volumes go back to normal levels this excess in working capital will go back into the business. So it was just as a slight mismatch, but that is completely temporary.

Q - Bruno Montanari {BIO 15389931 <GO>}

Okay. Thank you.

A - Wilson Ferreira {BIO 1528124 <GO>}

Thank you, Bruno.

Operator

Our next question is by Pedro Soares from BTG Pactual. Sir, you have the floor.

Q - Pedro Soares {BIO 20879952 <GO>}

Good afternoon, Wilson and Natal. I have the question about the company's capital structure and the investments expected ahead. You talked about an increasing leverage to 2.5x, and that's going to give us a better possibility of paying dividend and growing. So I think, you probably talk about that during the Investors Day, but I like to hear from you, do you think that there's potential investments to be made can be more significant in the short and medium term or is something for later on? I would like to understand the dividend potential since there has been a relevant cash generation and that might impact the leverage level. So can you talk about the trimming of investments? Thank you very much.

A - Wilson Ferreira {BIO 1528124 <GO>}

Indeed, the capital structure defined as 2.5x is -- so that we can perform a growth process. We see a lot of space to grow, not only in electrical power, but also consolidation of operations and natural gas and the growth of our convenience network. We chose this because we understand that this is something gradual and that will enable us to grow, when the conditions are favorable and we have M&A opportunities. So we want to prepare for that and that will create opportunities for shareholder compensation.

But we want to strengthen the company. We've talked about oil, fuel and coke itself, and there has been a reduction in those areas. But we are now investing in other long-lasting fields. So in general, we want to do things gradually. Considering the M&A opportunity that arise in those areas that I mentioned then that will open opportunity to generate cash and payout dividends. But I think Natal probably has something to add to that.

A - Andre Correa Natal {BIO 21073585 <GO>}

Yes, you're completely right. With a very robust cash generation that we've had as you know, and with the possibility of using a higher leverage band, we think that the cash that will be available to be allocated in the next five years is very significant. So we expect our business to demand about BRL1.5 million per year for the contract with the service station, BRL1.5 billion -- not million. So we have CapEx to maintain our infrastructure for logistics expansion going from BRL500 million to BRL700 million per year. So we're talking about some billions that are needed for our organic expansion. This is something that we require to maintain and grow about BRL2 billion total allocation per year, BRL2 billion to BRL2.5 billion per year.

Now, having done that, we expect around BRL15 billion to BRL20 billion to be allocated and added to the organic allocations. We will give you further details about that during our BR day. And those investments will give us opportunities for organic growth, as Wilson mentioned. And our energy transition with gas, electrical power and others, but it will probably be enough for us to make payments to shareholders as well. Because of the significant class generation that will happen during that period of time. So the choice between dividends or buybacks and others will depend on other issues that are not in our hands such as the tax reform and other parameters that we'll need to take into account. What matters is that we have the tools in our hands to make the choices that make more sense to our shareholders have different points in time.

So if we have different M&A opportunities or value generation opportunities will study them and we'll distribute cash or buyback shares when we can and we want to have all those levers in hand, the complex changes and we need to adapt to that. But my main message is, yes, there will be enough cash generation in 2021, we paid dividends in April and we have already announced the payments for September and December and there are also other dividends to be paid by the end of the year with a total distribution of BRL2.850 billion rounding these numbers.

These numbers are very relevant and I'm not considering any buyback here and we have around BRL1.5 million for buyback. So if we consider that, we would go above BRL4 billion, if do all of that by the end of the year, that we're doing (Technical Difficulty) making sure that this is not going to affect our ability to allocate capital. We're working on M&A projects and other organic allocations that will be made will not lose any opportunity for doing all of that. The accessibility [ph] for us to balance all of these levers and we want to be able to use all of them.

Q - Pedro Soares {BIO 20879952 <GO>}

That was very clear. Thank you, Wilson and Natal.

Operator

(Operator Instructions) Our next question is by Gustavo from Bradesco. You have the floor, sir.

Q - Analyst

Hello, good morning. I have two quick questions. The first is we saw an increase in savings. Is that something recurring?

A - Wilson Ferreira {BIO 1528124 <GO>}

I apologize Gustavo, we are having some technical issues with your audio and we cannot understand you.

Q - Analyst

Can you hear me better now?

A - Wilson Ferreira {BIO 1528124 <GO>}

Yes, it's better now.

Q - Analyst

Okay. So my first question is about the BRL100 million increase that you share during the presentation. Where is that coming from? Is that something recurring? And is there a possibility to increase the sales to thermals? When it comes to thermals, the numbers we've had in last quarter is very close to what we considered to be a stable position. We are the distributor of oil fuel and diesel for most of those thermal electrical power plants. So we think that considering the dispatch level that the government has defined, this will probably caps at least until the end of next year.

A - Wilson Ferreira {BIO 1528124 <GO>}

Now, the first question, I still don't understand what you said, the audio was chopping up. So maybe Natal has understood and maybe he can answer that.

A - Andre Correa Natal {BIO 21073585 <GO>}

We believe that these volumes have already achieved the levels of stability. But in the quarterly comparison, oil fuel distribution in the second quarter was higher in June for the thermal electrical power plants that we expect to see gain in the next quarter because the dispatch levels will be the same for the whole quarter and in the second quarter, this level was only seen during one month. So we expect a contribution that is about twice as high as what we saw this quarter. But about your first question, I apologize, we were not able to understand.

Q - Analyst

Well, we saw that this quarter compared to the previous quarter, there was a BRL100 million increase in terms of anticipated bonus. Why is that?

A - Andre Correa Natal {BIO 21073585 <GO>}

About anticipated bonus? Okay, you're talking about bonus. All right. These are amortizations that we make, and they have a direct relationship with the validity of contracts. And right now, we have shorter-term contracts that concentrates amortizations more in the quarter than they usually do. So we have contracts for the trademarking service stations that are long like seven years and now we have contracts of only three to four years in the level of amortization differs because of that dependent on the validity of the contract. Now, if this was recurring or not in the long term, we don't think that will have different contract duration our average is around five to six years, but of course, you can calibrate

longer or shorter duration contract depending on the context, but we don't think this is going to be relevant in the long term.

Q - Analyst

Okay. Thank you very much. That's clear.

Operator

Okay, we are now closing the Q&A session. I'd like to turn the floor over to Mr.Wilson Ferreira, Junior for his final remarks.

A - Wilson Ferreira {BIO 1528124 <GO>}

Okay, once again, I'd like to thank you all for joining our earnings conference call. And since this conference call was made almost at the same time as the launch, I would like to share with our position and the position as the other players including Petrobras, the IBT Institute defends the current rule for market positioning that enable us to have exclusivity contracts, ensuring fuel consumers all over the country to guarantee the products at the service station being sourced from the distributor with whom the service station has a contract, that is an assumption for a just and fair competition. So the provisional measure announced, this Wednesday, would enable service stations to offer products of different brands at their service station. We believe that the proposal will not bring benefits in terms of prices and information to consumers and it will increase regulatory and tax costs.

In Brazil, services stations already have the option of having a trademark or not the so-called white flag services stations account for about 47% of the market, which shall go out of competition between these two models. Now, dealers can choose a trademark, ensuring consumers, where the products come from and consumers, therefore, can choose a brand they trust.

In addition to operational difficulties, if we segregate tanks and pumps with products from different sources and the impossibility [ph] of separating in-person and virtual services that can be added the clarity of communication with consumers will be jeopardized. We believe that in benefit of consumers and contracts, we should look at the contracts that are key for fair competition and to supply the very large national territory. So I wanted to mention that to you, because this is something that will be discussed in the national congress, it needs to be accepted by the regulatory agency and it might be a coincidence that it's something that will affect all of the commercial relationships in which consumers that are defended by the consumer codes, consumer defense code and establish a relationship with the brand that works on quality of product, innovation, payment terms and so on.

So we would like to mention that our model is based on the trust that we have built in our relationship with consumers and the brand attributes that we added to the BR brand to all of our products and services and this our main differential and the strategy we're going to keep in the future. This country is growing and we believe that we'll be able to reinforce our differentials in the following months and years by doing that.

So I would like to invite you to take part in our event on September the 1st, where we will be able to share further details with investors, analysts and shareholders in the fruits of the work we've been doing at our company and how are we going to resource our competitive substantial (Technical Difficulty) the future. So please join us on September the 1st, when we're going to talk about (Technical Difficulty) afternoon.

Operator

Ladies and gentlemen, the audio of this conference call and the slide deck will be available at the website at ri.br.com.br. Thank you very much for joining.