Q1 2018 Earnings Call

Company Participants

- André Pires de Oliveira Dias, Chief Financial & Investor Relations Officer

Other Participants

- Frank McGann, Analyst
- Luiz Felipe Carvalho, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning ladies and gentlemen. At this time we would like to welcome everyone to Ultrapar's First Quarter 2018 Results Conference Call. There is also a simultaneous webcast that may be accessed through Ultrapar's website at ri.ultra.com.br, and MZiQ platform. Please feel free to flip through the slides during the conference call.

Today with us we have Mr. André 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 and all participants will be in listen-only mode during the company's presentation. After Ultrapar's remarks are completed, there will be a question and answer session. At that time further instructions will be given. We remind you that questions, which will be answered during the Q&A session, may be posted in advance in the webcast. A replay of this call will be available for one week.

Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of Ultrapar management, and on information currently available to the company. They involve risks, uncertainties and assumptions because they relate to future events, and therefore, depend on circumstances that may or may not occur in the future.

Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of Ultrapar and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I'll turn the conference over to Mr. Pires. Mr. Pires, you may now begin the conference.

André Pires de Oliveira Dias

Thank you very much. Hello everyone. As always, it's a pleasure to be here with you to discuss Ultrapar's first quarter 2018 results, as well as to give you some perspectives on the next few quarters. Here with me are the officers from our businesses, as well as the Investor Relations team to help answering your questions.

Before starting, I'd like to draw your attention to slide number 2, where we highlight the criteria adopted in the preparation of the published information and that is used in this presentation. All information shown in this quarter adopts the new criteria established by the IFRS 9 and 15 standards. This includes quarterly information for 2017, which consequently differs from amounts previously reported in the respective publications of results. So to keep the same basis of comparison, we are publishing comparative tables in our earnings release, the financial results, as well as in the Investor Relations website.

I would like to begin on slide number 3, an overview of events since our last call. As you may have seen, we announced important changes in our management. Paulo Cunha, Chairman of the Board of Directors, yesterday announced his understanding that now it is the time to complete the process of his succession, and thus secure a further step to ensure the company's perpetuity, and then he decided to leave the company's board of directors. In that sense, Ultrapar´s board of directors, in recognition of the inestimable value of his contributions appointed Mr. Paulo Cunha as the Chairman Emeritus of the Board, an honorary and lifelong position to be occupied by him as of this date.

Also on this date, Mr. Pedro Wongtschowski, kwon by many of you, current Vice Chairman of the Board of Directors and former Chief Executive Officer from 2007 to 2013, was appointed to succeed Mr. Paulo Cunha. Mr. Lucio de Castro Andrade Filho, who joined the company in 1977, and has been a member of the board of directors since 1998, was appointed for the position of Vice Chairman of the Board of Directors.

Both will occupy their roles for the remainder of their term of office (00:04:08) as directors. The board of directors will appoint in a timely manner, a new director who will serve until the next general shareholders meeting of the company, in accordance with the bylaws.

Additionally, the company informs that it received a letter from Ultra S.A. communicating that a shareholders' agreement was entered into by Ultra S.A. and Parth do Brasil Participações Ltda, holding companies of the two branches of the Igel family, as well as of former executives of the company.

This letter is available at the company's website, but I'll read a passage that says that the agreement aims to reinforce, without any change, the principles that have been governing the actions of the reference shareholders of Ultrapar, in favor of the continuous protection of all shareholders' interests and the guarantee that the company is managed in a professional and independent manner.

In November of 2016, we submitted the acquisition process of Liquigás by Ultragaz to CADE. For nearly 15 months between signature and a final decision, we worked hard to show CADE, the benefits of the transaction and to reach an agreement, which addressed the competitive concerns raised by the administrative court.

But in its ruling on February 28, the court decided by 5 votes to 2 to reject the acquisition and the operation therefore will no longer take place. Regardless, we will pursue other expansion plans for Ultragaz and Ultra. As we know the rejection of the acquisition resulted in a fine of BRL 286 million, paid in full on March 1, the date CADE's decision was published.

At our last presentation, we commented that the first quarter would be a challenging one for our business. In the first three months of the year, we have noted a slower than expect pace in the recovery of the economy, with the unemployment rate still high and the competitive environment still intense.

In the table at the top right hand corner of the slide, there are some indicators, which support our vision and will help us in the analysis of the impacts on the businesses. In the fuel distribution sector, imported volumes remained high during the quarter, despite the recent change in the sector's operating environment. In the LPG distribution sector, there was a significant increase in raw material costs during 2017. In pharmaceutical retailing, market growth was slower than expected over the last few months.

I should also highlight that certain non-recurring effects had an impact on our results, as I will explain during the course of the presentation. Consequently, adjusted EBITDA excluding non-recurring effects in the first quarter of 2018 was BRL 794 million, 12% below the same period of 2017.

Please note that for this EBITDA comparison, we are excluding the fine, which affected the results of Ultragaz this quarter and the reversal of the provision, which positively affected Oxiteno's results in the first quarter of 2017. Net earnings, in turn, were down 26%, also excluding the impacts of the fine.

Let's now move on to slide 4 with the performance of our fuel distribution business, Ipiranga. Sales volume in the first quarter of 2018 reached 5,461,000 cubic meters (00:07:39), a reduction of 2% compared with the first quarter of 2017.

Performance was influenced by one less business day in the period and this had a reducing effect of about 1.5% of the volume. The business environment also remained challenging with imported volumes still high in the market.

Otto cycle sales volume fell 2% compared with this first quarter of last year and diesel, 3%. It's important to mention, however, that the ethanol saw positive results with growth of 51% year-over-year, an atypical increase in this time of the year, reflecting the impact of gasoline prices combined with a more favorable parity and unemployment rates still high.

In the top right hand corner, we can observe in the chart that, throughout 2017, the imports of fuels were still attractive given the favorable parity. Only in the end of that year we saw the convergence of domestic prices to international references, mainly in diesel, indicating a more balanced market. Therefore, the first quarter was still influenced by a challenging competitive environment.

With this, Ipiranga posted an adjusted EBITDA of BRL 585 million in the first quarter of 2018, a reduction of 15% compared to the same quarter of last year. This was largely due to the lower sales volume, the intensely competitive trading environment and the increased level of expenditures with the startup of Iconic's operation including expenses with indemnities. If we exclude the impacts of the consolidation of our JV in the lubricant business and of the higher freight costs, Ipiranga's SG&A grew by 3% quarter-over-quarter.

As we have already mentioned, our outlook for growth in volume and results is based on three important assumptions: a recovery in the economy, a more balanced competitive environment, and the maturing of our recent investments. These factors tend to develop well, and for this reason our expectation is for volumes to recover with a positive impact on performance in the next quarters. However, taking into account the performance of this first quarter, our expectation for the EBITDA growth level is reduced.

Moving on now to Oxiteno on slide number 5. Our sales volume of specialty chemicals in the domestic market was down 4%, mainly due to a decline in sales to the agrochemicals and distribution segments. In the overseas market, specialty chemicals volume was down by 2%, due to more competitive markets.

This happened in spite of the higher sales to the (00:10:30) pre-marketing sales for the new Oxiteno plant in Pasadena. Sales volume in commodities fell 26% due to the scheduled stoppage at Camaçari. With decreases in specialty chemicals and commodities, Oxiteno's total sales volume in the first quarter of 2018 was 8% down year-over-year. Please note that despite volume performance, the sales mix was more favorable in this quarter with a higher percentage of specialty chemicals. In that sense, we started to notice unitary margin expansion in dollars for Oxiteno.

Two factors affected our quarterly results more significantly; pre-operational expenditures in preparation for startup of the new plant in the U.S.A and higher expenses with the stoppages at Camaçari, the latter having a BRL 15 million impact. These two factors, added to the decline in sales volume, produced an EBITDA of BRL 51 million in the first quarter of 2018, 17% less when compared to the same quarter in 2017, in spite of the 3% depreciation in the real against the dollar and unit prices in dollar also (00:11:38) positive impact on EBITDA. This comparison ignores the non-recurring effect of BRL 49 million in the first quarter of 2017, due to the reversal of the provision for excluding ICMS sales tax from the calculation of the PIS and COFINS charges.

Looking ahead to the second quarter of 2018, the trend is for volume growth both for specialty chemicals and commodities. On EBITDA, the expected growth in volume and the recent devaluation of the real against the dollar plus the expansion in unitary margins in U.S. dollar, should translate into an improvement in EBITDA for this quarter and consequently year-over-year growth. For the year as a whole, we expect volumes to continue on a growth trajectory both due to the economic recovery and also the startup in operations at the new plant in the U.S. and scheduled for late – for the second quarter of 2018.

Moving on now to Ultragaz on slide number 6. First quarter of 2018 sales volume at Ultragaz fell 1% compared with the first quarter of 2017, reaching 410,000 tons. In the bottled segments, the sales performance was stable year-over-year, with 1% growth per business day. In the bulk segment, sales volume was impacted by the programmed volume reduction of an industrial customer, but partially offset by improved performance in the industrial segment and condominiums.

Ultragaz reported one more quarter in which initiatives for reducing expenditures had a beneficial effect on EBITDA. This improved in the first quarter of 2018 by BRL 116 million or 3% compared with the first quarter of 2017, disregarding the CADE fine and despite lower sales volume. As we've already mentioned, there was a non-recurring effect from the payment of the fine of BRL 286 million following the rejection of the Liquigás acquisition.

Our expectation for the current quarter is for a positive evolution in volume. We continue to pursue actions for reducing expenditures, so allowing a better year-on-year performance than in the first quarter, not considering of course the effect of the fine.

Let's go on now to talk about our liquid bulk storage business, Ultracargo in slide number 7. Ultracargo's average storage area increased by 4% compared with the first quarter of 2017. This was due to an increased fuel and ethanol handling at the Itaqui and Santos port terminals, in the case of Santos reflecting the partial resumption in activities in June of 2017.

In the first quarter of 2018, Ultracargo's EBITDA was BRL 41 million, an increase of 87% year-on-year due to greater average storage, again a reflection of partial resumption of activities at Santos, in addition to higher price at the terminals. Note that this comparison is affected by expenses of BRL 16 million in the first quarter of 2017 with the Santos incident.

For the second quarter, the dynamics are very similar to the last quarters, with growth in bulk liquid handling, and therefore, confirming the tendency that the level of results this first quarter will be repeated in the second. In this context, Ultracargo will focus its efforts on expanding capacity and using its position of leadership as a growth lever to achieve still more positive results for 2018.

Moving on now to slide number 8, let's talk about our pharmaceuticals retailing business, Extrafarma. Before going to Extrafarma results, I would like to inform that André Covre, kwon by all of you, decided to step down from his position as Chief Executive Officer of Extrafarma and engage with new professional and personal projects.

Rodrigo Pizzinatto was chosen to assume his position, and he is also kwon by many of you as he has been in Ultrapar for near 20 years since his internship. In Ultrapar, Rodrigo held executive positions in Corporate Planning, Investor Relations and M&A, and since 2014 is the Commercial, Marketing and Logistics Executive Officer at Extrafarma.

André and Rodrigo will start a transition process in which they will cooperate to perform a natural handover, a feature of Ultra's culture. Besides that, it is an internal succession. We would like to thank André Covre for 15 years of great contributions and wish Rodrigo good luck.

Extrafarma recorded a 25% increase in the number of drugstores in its network, ending the quarter with 401 stores, a gross addition of 100 stores in the last 12 months. At the end of the quarter, 54% of the stores had been operating for less than three years compared with 45% in the first quarter of 2017. This reflects the increasingly rapid expansion of the network, a notable event being the opening of the first drugstore in the state of Amazonas, the 13th state to have an Extrafarma.

First quarter gross revenue was 14% above the first quarter of 2017, with a 30% (00:17:11) growth in retail sales resulting from a larger average number of stores and a more intensive pace of promotional activities. It is important to mention that in addition to the strong comparison base of the first quarter of 2017 when sales growth was 36%, in the first quarter of 2018, Extrafarma's gross revenue was also affected by slower growth in the market. On the same comparative basis, sales data published by Abrafarma rose by 6%. Therefore, slower growth in sales and the larger number of maturing stores resulted in an EBITDA close to zero in the quarter. Excluding the effect of the new stores, EBITDA reached BRL 11 million compared to an EBITDA of BRL 15 million, excluding non-recurring effects in the first quarter of 2017.

For the current quarter, we shall maintain our strategy of organic growth, which depresses EBITDA in the short term. However, we are forecasting a recovery for the second quarter results, returning to the levels that were presented in the second quarter of 2017.

In this last slide, I would like to comment some aspects, which convince us that we are on the right track so far for generating consistent value despite the challenges, which lie ahead. We begin operations at our Oxiteno plant in the U.S.A at the end of the second quarter. This will benefit our margins over the year. We shall also be finalizing the entry into operations of Iconic, our new lubricants company in partnership with Chevron, helping to boost Ipiranga's results.

In addition to this, we are also been working on other organic growth fronts. At Ipiranga, we are expanding the network of service stations and franchises, so that we maximize the strategy of differentiation through constant innovation in services and convenience, helping us increase client flow, satisfaction and loyalty.

And it is important to mention that the addition of service stations through organic investments in the previous year was concentrated in the end of 2017, and therefore, several stations are still in a pre-operating stage and should start to contribute positively to volumes as they become operational. Meanwhile at Ultragaz, we have the opening of resellers and the capture of new clients, at

Extrafarma, an expansion in the network of pharmacies and entry into new markets, and at

Ultracargo, the expansion of its capacity.

Regarding our investments, we continue to see good opportunities in our businesses. It is important to mention that the limited amount – the limit approved – the budgets limit approved by the end of the year is based on macroeconomic assumptions that should be put to test during the year. On that sense and, considering the comments we have already made on the economic environment, we are slowing the pace of investments for 2018, seeking the balance between our continuous expansion, expected levels of returns and cash generation.

It is important to emphasize that despite lower results year-on-year, our investments, sense of opportunity and discipline in the use of capital gives us the confidence to continue growing. We can also count on the proven capacity of our teams to execute our business plans, as well as a comfortable and solid financial position with strong operating cash generation during the year reducing debt, circumstantially above our historic levels.

With this, I come to the end of what we prepared for today. I would like to thank you for your attention and would welcome any questions you might have. We can now begin the questions and answers session.

Q&A

Operator

Thank you. And our first question will come from Frank McGann of Bank of America Merrill Lynch.

Q - Frank McGann {BIO 1499014 <GO>}

Hello. Good day and thank you. I was just wondering if we could maybe focus on two things. One, just in terms of Ipiranga, results came in relatively weak and you indicated that you expect some improvement as you go forward over the next several quarters, although perhaps a little bit lower than you might have expected before.

I was wondering if you could maybe provide a little bit more information on exactly what you are seeing, specifically as it relates to both the competitive environment, how you are seeing the key competitors response, whether you're finding it more complicated to renew franchise agreements, so those agreements would be coming a little bit economically less favorable for the company.

And then secondly, just in terms of the investment program, you indicated you are slowing it. What areas would you like to most see that in? And in the quarter you did not open (00:22:44) stations. So, I was just wondering if perhaps that's one area where you're looking to see lower investments in 2018.

FINAL

Bloomberg Transcript

A - André Pires de Oliveira Dias

Hi, Frank. Thanks for the questions. With the first question, talking about the expectations in terms of improvement for the next quarters, I think your comment is right.

Obviously, we – at least in the end of last year, we were not anticipating first quarter starting slower than – the first quarter started much slower than we expected effectively and this obviously affects the overall results for the year.

However, this is both for volumes and also on the competitive environment as well. Basically, what we saw in the first quarter was an excess supply in terms of imported fuel, which came at very low levels of prices, and therefore, the whole market in the end had to go down in order to compete for this excess supply. We are seeing a reduced level of imports in the beginning of the second quarter. So, the percentage of imports in the market has been coming down. And the imports that are coming are coming with less competitive than they were let's put in the first quarter.

Because of that we are, yes, expecting improvements in terms of both volumes and margins from the second quarter on. In fact, if we talk about April specifically, we can already see volumes above April of last year, which indicates the recovery that we are seeing in the second quarter. So, with that, what we basically mentioned – what I mentioned in the call is that we are expecting to see better results in the quarters to come for Ipiranga.

In terms of the competitive environment, we are not seeing more difficulties in terms of, for example, branding unbranded gas stations or converting unbranded gas stations. In fact, we believe the supply has already increased because of the change in the competitive environment. (00:25:20) mainly unbranded gas stations are more willing to be converted than before.

Obviously, there is competition to convert them, which has always been the case, but we see an increase of supply, which should come in favor of our selectivity in terms of choosing the right ones and keeping the levels of returns that we have.

In terms of the CapEx, our organic investments, the reduction should be around 20% across the board. I think the exception might be Oxiteno because we have basically to conclude the construction of our plants in Pasadena and this plant should start to operate in the second quarter. But the other businesses they have more focus in terms of expansion type of CapEx, which we can slow down due to a relatively short cycle of investments for these businesses.

And you're right. Normally, we have a first quarter that tends to be weaker in terms of opening up gas stations than the other quarters, but this first quarter was weaker than the first quarter of last year, and this is an indication of the slower pace that we are considering. So, this CapEx adjustment should bring us back to the same levels of CapEx that we had in 2017 and should contribute to a more let's say significant reduction in our leverage and we have the objective to bring the leverage that was, let's say specifically higher than our average in this first quarter. Expectations to bring this leverage to the same levels that we had in average before, so substantially below 2 times. So, that's the idea.

Q - Frank McGann {BIO 1499014 <GO>}

Okay. So, would you by any chance have an estimate of how many stations you might be targeting this year now to add net to Ipiranga?

A - André Pires de Oliveira Dias

No, not at this point. Not at this point. We don't have a specific estimate in terms of number of gas stations. But again, in terms of CapEx, it should not be very different than what we did in 2017.

Q - Frank McGann {BIO 1499014 <GO>}

Okay. Thank you very much.

Operator

The next question comes from Luiz Carvalho of UBS.

Q - Luiz Felipe Carvalho {BIO 18040760 <GO>}

Hi, thanks André, for taking the questions again. Just two questions from my side. Imports are not dropping as expected in the year since December, and despite we saw some decrease when we compare to December levels, as we had lots of, I would say long-term (00:28:08), and also due to Petrobras' renegotiation. I think that they tried (00:28:15) some minimum utilization rate in the refinery. So, assuming that there is no (00:28:24) import gain and inventory gain this quarter, what can you expect in terms of recurring margins looking forward, assuming I would say the volume growth that you forecasted?

And second question, I just would like to follow up at what stages the renegotiation contract with Petrobras and Ipiranga, in terms of how this could impact your dynamics with the supplier. Thank you.

A - André Pires de Oliveira Dias

Hi, Luiz. Well, talking about import levels, I think it was very clear that imports started the year much stronger than anyone anticipated. They have slowed down a little bit in February and March, and we are expecting that it will continue to slow. But again, we do not see, as we mentioned many times, that imports will disappear from the market. I think that the market will have a more even competitive environment, a more equilibrated competitive environment. This is the expectation.

In terms of recurring margins, EBITDA (00:29:43) cubic meter, as I mentioned before, it's very difficult to predict, but you can estimate that, throughout 2017, import gains probably represented BRL 5 to BRL 7 per cubic meters throughout the year. So, obviously this BRL 5 to BRL 7, probably, right, if the premium remains close to zero will disappear. So, that's a good number for you to work on your models.

Talking about negotiation, the supply contract with Petrobras, there is no news about that. This is, as far as we understand, is being discussed between the distributors and Petrobras. I think that what Petrobras is trying to achieve obviously is good terms with their distributors. But we don't see any significant change in the operational environment that could potentially let's say change the market dynamics significantly.

Q - Luiz Felipe Carvalho {BIO 18040760 <GO>}

Okay. Thank you.

Operator

We do have a follow-up question from Frank McGann of Bank of America Merrill Lynch.

Q - Frank McGann {BIO 1499014 <GO>}

Yeah. Just – in Extrafarma, at different points in time, management has suggested that, if the conditions were attractive, M&A could be a way for Extrafarma potentially to expand or expand more rapidly and add a lot more mass to the company. I was just wondering what you're thinking right now, given changes in the market, and it seems to be a little bit more difficult market, more difficult to expand, if that might be an option for the company.

A - André Pires de Oliveira Dias

Thank you, Frank. Well basically, I think we have mentioned many times that, let's say, our strategy, our focus, is organic growth. We understand that organic growth in terms of return on invested capital, ROIC, makes more sense than let's say bolt-on acquisitions. And bolt-on acquisitions have lot of challenges in terms of combining many different management standards, many different ways of doing businesses that could be very difficult to integrate. So, clearly, our focus is to grow organically. We don't see let's say much value in doing a transformative M&A at this point in the case of Extrafarma. So, the focus is to grow organically.

Obviously, as it is part of our culture and part of our tradition, we will not simply close our eyes to interesting M&A opportunities if they appear. We do not have any plans, but we are always going to look into it if there is an opportunity that we can mitigate those risks of integration that I mentioned before. But at this point, we don't have a target and our objective is to continue to grow organically.

Q - Frank McGann {BIO 1499014 <GO>}

Okay. Thank you very much.

Operator

This concludes the question and answers session. At this time, I would like to turn the floor back to Mr. Pires for any closing remarks.

A - André Pires de Oliveira Dias

Okay. Well, thank you very much. Thanks for listening to the call. And hope to see you all again, when we discuss our second quarter results. Thank you and good afternoon.

Operator

Thank you. This concludes today's Ultrapar first quarter 2018 results conference call. You may disconnect your lines at this time.