Q1 2017 Earnings Call

Company Participants

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

Other Participants

- Lillian Yang, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to Ultrapar's 1Q17 Results Conference Call. There is also a simultaneous webcast that may be accessed through Ultrapar's website at www.ultra.com.br/ri and Engage-X platform. 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 from 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. (Operator Instructions) 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.

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

Thank you very much. Good morning, everyone. It's a pleasure to be here with you to discuss Ultrapar's 1Q17 results. Here with me are officers from our businesses as well as the Investor Relations team to help answering your questions.

Starting with slide number 3, I'd like to open our discussions today with an overview of the main developments at Ultra, since our last call three months ago. The macroeconomic environment in the first quarter remained challenging. However, we're starting to see signs of a gradual recovery in the Brazilian economy, which benefits our segments mostly in the GDP performance. A more stable environment together with investments and the strategic initiatives we're implementing allow us to pursue a best [ph] of sustained growth at Ultra, both in 2017 and in the long run.

In the first three months, we executed our CapEx plan by deploying BRL485 million in expanding our scale and the quality of operations, intensifying the initiatives of differentiation and modernization. We continue to implement our plan of expanding Ipiranga service station, Ultragaz resellers and Extrafarma stores. Our project on Oxiteno's new ethoxylation plant in the United States is also evolving. In February, we obtained one of the approvals for Ultracargo's capacity expansion plan at the Itaqui port terminal. Overall Ultrapar's CapEx plan for 2017 is BRL2.2 billion.

We have also been working on other sources of growth and value creation. One of them has recently taken a step forward by receiving a final approval from the Anti-Trust Authority, CADE, to create a new look lubricants company in a joint venture between Ipiranga and Chevron. We're currently streamlining the integration plan in order to have a single company up and running, combine the lubricants businesses of both companies by the end of the year.

In addition, we have filed a request with CADE for the approval related to the acquisition of Liquigas and the transaction is currently under analysis with the General Superintendence Department. CADE approval is a condition precedence for completing the transaction and if it takes place Ultragaz and Liquigas will remain competitors, conducting their businesses in their normal course. As for Ale, we're working towards a final decision from the (inaudible) Administrative Court, which is expected to happen in the next few months.

More recently, we announced the issuance of a tax incentive bond in the domestic market at a very favorable terms and cost. We successfully raised BRL1 billion at an average cost of 94.6% of CDI, which Brazil's base interest rate with a five and seven year maturities. Consequently this has reduced our average cost of debt and at the same time lengthened our debt profile.

As I said, both organic and inorganic initiatives will strengthen our growth avenues and we're confident of the benefits they will bring to both our businesses and the society as a whole.

Now, let's move on to slide number four and talk about Ipiranga. One of the key growth leverage in 2017 at Ipiranga is the accelerated expansion of the service station network and we expect that its benefits will rise as the new stations mature. The network grew by 6% year-on-year basis with a net addition of 407 units to the network in the last 12 months and 85 in the quarter itself.

This quarterly growth is somewhat unusual for the first quarter of the year, which typically tends to be slower in both investments and service station additions. We closed 127 service stations in the past 12 months and 7 in the quarter within our historical average. At the end of March, we had total of 7,648 service stations.

Ipiranga's volume in the first quarter of 2017 was 6% lower year-on-year. It was an improvement compared to the 14% decline year-on-year in the fourth quarter of 2016, compared with the same quarter in 2015. Otto cycle volume was 3% down in volume, a reflection of the challenging economic scenario and further deterioration in unemployment [ph].

However, the falling sales volumes have been reducing month-over-month, while investments in the roll out of new service stations will continue to drive a progressive recovery volumes.

Diesel volume was 10% down compared with the first quarter in 2016 in line with the performance of the economy as a whole and lower market share in the large consumers and transport retailer segments.

As a result EBITDA reached BRL705 million in the first quarter of 2017, almost stable in relation to the first quarter of 2016 despite the lower volume and cost movement. It's important to highlight that Petrobras implemented one cost increase and two reductions in the Diesel segment and two cost reductions in the gasoline throughout the first quarter of 2017.

As to the current quarter, we expect the continuity of the trend seen in the first quarter, both in volumes, progressively improving and also in EBITDA. We remain confident in a more consistent growth in the second semester keeping our outlook for growth in the year as a whole.

Moving on now to Oxiteno in slide number 5. In the first quarter, volumes continued to recover with an improvement of 8% year-on-year. If you break down the number, volumes of specialty chemicals in Brazil had a 5% growth compared to the first quarter of 2016, the third consecutive quarter of year-on-year growth as a consequence of larger recovery in the Brazilian industrial production chain. The highlights was volumes in the oil and gas, coatings and automotive fluid segments and coating in automotive fluid segments.

Growth in international market was 13%, this was a reflection of higher sales in the US, due to the pre-marketing of our new ethoxylation plant in Pasadena, Texas focusing the above chemicals market. Commodities volumes was also 10% up year-on-year reflecting better demand for these products.

In the first quarter, the average real dollar rate appreciated by 20%, the same trend seen in the past quarters. Raw material cost continued to increase, especially prices of palm kernel oil, 48% higher compared to the first quarter in 2016.

Oxiteno's EBITDA was BRL62 million, year-on-year decline 69% largely linked to a BRL0.77 appreciation in the exchange rates compared to the first quarter of 2016 as well as to the higher cost of certain raw materials.

We also reported a one-off event in this quarter. We reversed a provision of BRL49 million related to the exclusion of the ICMS sales tax from the calculation base for the PIS and Cofins taxes, resulting in a reported EBITDA of BRL112 million for Oxiteno. This reversion was based on a Supreme Court ruling, which decided that the inclusion of the ICMS in the calculation was unconstitutional and is backed by the opinion of our legal counsel.

As we mentioned last year, during 2017, we will be preparing Oxiteno's structure for the expansion in the United States. Over the past few months, we progressed on the construction of the new plant. The reactive component is being built in Thailand and will be shipped in modules to the US for assembling, which is expected to be concluded in late 2017, early 2018. So this year we'll have some pre-operating expenses due to the plant and this will initially impact our EBITDA.

We expect further growth in specialty chemical sales to the domestic market for the current quarter. However, raw material price volatility and exchange rate will continue to compress margins with an additional effect of inventory loss due to significant drop in the palm kernel oil prices by the end of first quarter.

Now moving on to slide number 6 and talking about Ultragaz. Ultragaz has continued to outperform the market by reporting more volumes in spite of the weakness in the economy. In the first quarter of 2017, consolidated sales volume was 414,000 tons, a 2% growth year-on-year. As in previous quarters, this growth reflects investments in new resellers in the bottled segment and in attracting new clients in the bulk segment especially in the industrial and residential condominium segment. Both bulk and bottled segments presented volume growth of 2% in the period.

Ultragaz adopts the strategy of creating new market initiatives in the bulk businesses and diversifying solutions in LPG utilization as in the asphalt plants where we saw significant year-on-year growth. In addition to the capture of new clients and resellers, Ultragaz initiatives also included, increasing differentiation in the market by offering consumers greater convenience, diverse and greater quality and value to our business.

Due to the initiatives like expansion and differentiation, Ultragaz EBITDA increased by 11% year-on-year. For the current quarter, the growth rates in the bulk segment tends to decline driven by a relatively high comparable base in the second quarter of 2016 when sales to the industrial segment were particularly strong. As for the EBITDA, we expect the growth trends in the first quarter of 2017 to be maintained.

Let's now move on to slide number 7 and talk about Ultracargo, our liquid bulk storage business. Ultracargo's total average storage increased by 6% compared with the first quarter of 2016, largely due to the greater fuel handling activities at the Suape and Aratu port terminals. The average capacity utilization in the first quarter was 89%, even considering the non-operating area in the Santos terminal.

Ultracargo posted an EBITDA of BRL22 million in the first quarter, equivalent to drop of 32% year-on-year, mainly due to BRL30 million advance on insurance claims in the first quarter of last year, which strengthened the comparison base. On the same comparison and excluding expenses and insurance related to the fire at Santos terminal, which are shown in the graph on the right hand side, EBITDA increased by 48%. This reflects both growth in average storage as well as higher average tariffs.

For the current quarter, we continue to see the same trend with strong levels of fuel handling and EBITDA compared with the previous quarter. As a reminder, it's important to highlight that in the second quarter of 2016, we also received BRL30 million advance on insurance claims, which will again affect year-on-year comparisons of EBITDA in the next quarter.

Moving on to slide number 8 with Extrafarma. Extrafarma ended the first quarter with 321 drug stores, a net increase of 60 stores compared with the end of the first quarter of 2016. During the first quarter of 2017, we added 12 new stores and closed six.

Gross revenues at Extrafarma rose by 28% compared with the first quarter of 2016, mainly due to the greater average number of stores and the 24% growth in the same store sales.

On the same comparison, overall revenues in the market grew by 9% according to Abrafarma information.

First quarter EBITDA at Extrafarma amounted to BRL4 million, which is BRL1 million below the first quarter of last year. The impact here was largely due to nonrecurring expenses of BRL11 million related to the indemnity payment and to the transfer of the distribution center from Belem to the neighboring city of Benevides with a more modern installation and better logistics conditions.

If we exclude these expenses, EBITDA would have been BRL15 million, well above the BRL5 million posted in the first quarter of 2016. We expect strong growth to continue in both revenues and EBITDA. It is important to highlight however that revenues [ph] will reduce its growth pace due to the lower price increases in pharmaceutical drugs announced by the regulatory agency at 4% in 2017, which was below the 12% increase announced in April of 2016.

Moving now to the final slide, slide number 9 and to close this presentation today, I would like to outline the strategy and priorities that base our expectations for the year as a whole. As we have seen over the last few quarters, there has been a gradual improvement in our operational environment indicating recovery volumes for those segments that are more linked to the economic performance.

Our investments, our ability to see the opportunities and our discipline in use of capital has brought us to where we're now, leaving us well prepared and stronger to take advantage of the recovery.

We're confident in the performance of Ultra's businesses and sustained growth in 2017. Such growth might come from the accelerated expansion in Ipiranga service station network, the focus on specialty chemicals innovation and international expansion at Oxiteno, the continued strategy of differentiation at Ultragaz, the resumption of Ultracargo's activities at the Santos terminal and a further acceleration in Extrafarma's expansion.

With this I conclude our presentation for today. I'd like to thank you for your attention and I welcome you to any Q&A you may have. Thank you very much.

Questions And Answers

Operator

Thank you. The floor is now open for questions. (Operator Instructions) The first question comes from Lillian Yang of HFBB [ph]. Please go ahead.

Q - Lillian Yang

Hi, thanks for taking my call, it's Lilly. Could you give us a little bit of color on how you see the few demand distribution in the competitive environment? Your margins, of course, they are a little bit up versus first quarter and down versus fourth quarter, but how do you see that going forward? You mentioned in the press release, there has been a little bit market share in the resellers business. Can you also talk about it? Thanks.

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

Hi, Lilly. Thanks for the question. Basically when you look at our margins measured by EBITDA equilibrium, we saw an increase of 6% in the first quarter of 2017 versus the first quarter of 2016. Obviously, from a seasonality point of view, normally the fourth quarter has always a much higher EBITDA opportunity type of indicator, which happened obviously in the end of last year as well.

What we have been telling our investors and the market in general is that we should concentrate and focus on the absolute EBITDA that Ipiranga generated obviously in 2016, in the first quarter of 2017 and our expectations for the absolute EBITDA for the year of 2017 as a whole. We are assuming performance in terms of EBITDA growth, which is very similar to what we had in 2016, but with different drivers.

While in 2016 this performance came exclusively from margins, in 2017, we're seeing a combination of better volumes and also the continuation of margin improvements at a slower pace than 2016, but a growth nevertheless. So that is talking about EBITDA.

Regarding, let's say, the competitive environment and market share changes, what we can say is that with accelerated expansion of our network, of Ipitanga's network, which started to accelerate more intensively in the third and the fourth quarter of 2016 and obviously also in the first quarter of 2017, there expansion to bear fruits -- are starting bear fruits as much as the network that is being added starts to become more mature. So these situations are in line with our strategy that is based in accelerating the expansion of our service stations network.

Q - Lillian Yang

Okay. So just for me to understand a bit, yes, margins as you know, they're improving very slowly, they should improve going further. But I also see that your CapEx investments are growing and your working capital client financing is growing as well. So how can I think about this CapEx cycle because if I read it well, like the ROIC or ROEs of this year and maybe next year, will it still be lower than when you compare versus the prior maybe three years there, and if you think then only within three years from now the returns -- ROIC will be going back to the levels of three years ago or you think it's going to be faster rate?

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

Well, when we talk about CapEx, our CapEx comparison with the first quarter of 2016 was higher. It was higher because we -- if you look at Ipiranga's expansion last year, the curve was very much inclined towards the end of the year, so we accelerated our CapEx in the third and fourth quarter of last year.

For this year, we're expecting a more let's say, more equilibrium in the distribution of our CapEx throughout the year, should be more acquisitive. So you should see a CapEx expense, which you may, at the same levels throughout the four quarters of 2017. Obviously our CapEx plan as I explained in the call for 2017 is higher than 2016. We have a CapEx budget of BRL2.2 billion.

In addition to the accelerated expansion of Ipiranga, we have also some other important projects this year such as the construction or the final part of the construction of the ethoxylation plant of oxygen in Pasadena, Texas and also the expansion of our port terminal Itaqui for Ultracargo. But on and on, we -- this should not impact significantly our ROE. Our ROE should be maintained at the same levels we've been seeing the ROE, even with these increase in our CapEx. So there -- you should not see a difference because of the accelerated CapEx at this point in time.

Q - Lillian Yang

Okay, thank you.

Operator

(Operator Instructions) This concludes the question-and-answer section. At this time, I would like to turn the floor back to Mr. Pires for any closing remarks.

Well, thank you everyone. I hope to see you all again on our next call in August. Thanks very much. Bye-bye.

Thank you. This concludes today's Ultrapar's 1Q17 results conference call. You may disconnect your lines at this time.