Q4 2018 Earnings Call

Company Participants

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

Other Participants

- Francis J. McGann, Analyst
- Gabriel Barra, Analyst
- Lilyanna Yang, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to Ultrapar's Fourth 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 on the 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 begin the conference.

André Pires de Oliveira Dias

Thank you very much. Hello, everyone. It's a pleasure to be here with you to discuss Ultrapar's fourth quarter 2018 results, and also to tell you about our perspectives and priorities for the next quarters. With me today are the officers from our businesses as well as our Investors Relations team.

Starting with the slide number 3, let's begin with the consolidated results for Ultrapar in the fourth quarter. Net revenues amounted to BRL 23 billion, 10% higher than in the fourth quarter of 2017, with growth in all our businesses. Adjusted EBITDA was BRL 993 million, a reduction of 5% compared with the same quarter in 2017, due to lower EBITDA at Ipiranga and Extrafarma. However, in relation to the third quarter of 2018, we saw a 17% increase in adjusted EBITDA.

During the fourth quarter we continue to see a gradual recovery in Ipiranga, both in terms of margins and market share, following a period of a more challenging operating environment during the first half of 2018 and more intense competition. Net earnings were BRL 496 million, an increase of 27% compared with the fourth quarter of 2017, mainly due to better financial results despite the lower EBITDA in the period.

In 2018, Ultrapar's net revenues were BRL 91 billion, 14% higher than in 2017; again, reflecting the increase in revenues at all the businesses. Adjusted EBITDA reached BRL 3.1 billion, a decrease of 23% in relation to the previous year, due to lower EBITDA at Ipiranga, Extrafarma and Ultrapar, the latter being impacted by the breakup fees from CADE's rejection of the Liquigás acquisition in February.

Net earnings for 2018 were BRL 1.1 billion, a 26% reduction compared to 2017. The board of directors approved the distribution of BRL 380 million in dividend for the second half of the year, equivalent to BRL 0.70 per share, which together with the dividends paid in August corresponds to a payout ratio of 60% for 2018 and a dividend yield of 2.5%.

Ultrapar net debt was BRL 8.2 billion in December 2018, a reduction of BRL 1 billion compared to September. That's equivalent to a leverage of 2.7 times net debt to EBITDA and lower than the 2.9 times for the third quarter of 2018. Reduction in financial leverage was due to an important increase in operating cash flow generation in the quarter, coming from initiatives to optimize working capital and more steady activity in our CapEx plan.

2018 CapEx was BRL 1.9 billion, 15% decrease compared with 2017 and 27% less than our original budget announced in December of 2017. For 2018, we announced CapEx plan of BRL 1.8 billion, which is lower than 2018, but sufficient to keep the company's sustainable growth.

We are committed to the selectivity and discipline of capital allocation. And we have undertaken a series of initiatives with our partners which will allow us to grow with lower CapEx.

Thanks to these initiatives, we ended 2018 with operating cash flow generation of BRL 1.4 billion, an increase of BRL 1.1 billion compared to 2017, despite a BRL 112 million reduction in EBITDA for the period.

Let's now move on to Ipiranga's performance in slide number 4. Sales volume in the fourth quarter of 2018 reached 6.2 million cubic meters, an increase of 4% compared with the fourth quarter of 2017, with growth of 4% in Otto cycle and 3% in Diesel, with an improvement in sales especially to the resellers segment. In the Otto cycle, such growth came after three consecutive quarters of decline, an important sign of recovery.

Now, I'd like to draw your attention to the new criteria adopted for the number of service stations disclosed. The aim is to provide greater consistency between the published network figures and the volumes sold. The principal difference is that now we are reporting the network additions from the inauguration of service stations where in the previous model, the criteria was from the signing of the contract. You can find more information on this thing in our earnings release on our table on page 17.

The 'am/pm' convenience store chain grew by a further 78 stores, 67 bakeries and 54 beer caves compared with the same period in 2017. The Abastece aí app reached the five million transactions mark in the fourth quarter of 2018, with the inclusion of more than 1.4 million in Itaqui (00:07:17) clients driven by the year-end holiday commercial campaigns.

The results for the quarter showed a positive progression from the third quarter of 2018 and continued the trend observed in the last few months. Adjusted EBITDA fell by 35% from the fourth quarter of 2017, due to lower margins given the strong comparative days with import gains in the fourth quarter of 2017, as well as the negative impact of inventor in the fourth quarter of 2018.

Looking at the full-year performance, sales volume reach 23.7 million cubic meters, a growth of 1% over 2017. This breaks down into an expansion of 2% in Diesel and a decrease of 1% in the Otto cycle. Adjusted EBITDA was BRL 2.1 billion, 33% lower when compared to 2017 due to a higher comparative base, with imports and inventory gains in 2017 and also due to the impact of the truckers drivers' strike in 2018.

We have noticed a more balanced operational environment at the beginning of this year, as a result of the recent reduction in fuel costs, which contributed to softer demand growth and a pricing policy in line with international prices. For 2019, we expect growth above the GDP growth in volume, as well as a significant recover in EBITDA relative to 2018.

Volumes so far have outperformed our forecast for diesel, and we saw a greater mix of ethanol in the case of the Otto cycle. With this, we expect to see growth in volume compared with the first quarter of 2018, and we continue to observe a sequential improvement in profitability, adjusted by the seasonality among periods.

Now moving on to slide number 5, talking about Oxiteno. Oxiteno's total sales volumes in the fourth quarter of 2018 was a 190,000 tons, a reduction of 6% compared to the fourth quarter of 2017. Specialty chemicals sales volume fell by 10% again in relation to the same quarter in 2017, due to lower sales to the agro business, automotive segments and to Argentina, despite higher sales in the United States.

Commodity volumes increased by 12% over the same period in 2017. This is due to the stronger demand from the domestic market. Oxiteno's EBITDA was BRL 280 million in the quarter, of which BRL 186 million is the matter of fact of tax credits on our final ruling in Oxiteno's favor on the excluding of the ICMS sales tax from the PIS/COFINS calculation base. If we exclude this effect, EBITDA would have reached BRL 94 million, a 22% increase compared to the fourth quarter of 2017, due to an improvement in margins and depreciation in exchange rates during the period.

Looking at the performance for the full year, total sales volume at Oxiteno was 769,000 tons, a reduction of 3% compared with 2017. This was due to a 5% lower sales of specialty chemicals, despite an increase of 8% in commodities. Without considering the non-recurring tax credits, Oxiteno EBITDA for the 2018 was BRL 439 million, an increase of 48% compared to 2017, due to both a higher unitary margin in U.S dollars and a more depreciated real.

The new Texas unit is ramping up for operations according to plan. Production is increasing and there has been some important commercial developments with the signing of new contract and the certification of products for new markets and segments. For 2019, we expect to see a continuation in Oxiteno's favorable operational environment, driven by the larger ramp-up in the new plant and contributing to increased volume and profitability. For the current quarter, we are forecasting an increase in sales volume as well as EBITDA relative to the first quarter of 2018.

Moving onto slide number 6 and talking about the performance of Ultragaz. In the fourth quarter, sales volume was down by 1% on a year-over-year basis. The bottled segment grew by 1%, while bulk volume declined by 5%, mainly due weaker demand in the industrial segment. EBITDA at Ultragaz was BRL 121 million in the quarter, an increase of 151% compared with the fourth quarter of 2017 and a reduction of 8% if we exclude the amount of the agreement signed with the Anti-Trust Authority in the fourth quarter of 2017. Again, largely due to lower sales volumes to the industrial segment.

In 2018, sales volume fell by 1% in relation to 2017, in line with a decline in the overall Brazilian LPG market. The bulk segment fell by 3% and the bottled segment remained stable. In this scenario, Ultragaz market share was unchanged in relation to 2017.

If we exclude the non-recurring impacts, EBITDA for 2018 was BRL 544 million, a 4% improvement in relation to 2017, mainly due to the reduction in SG&A expenses. For 2019, we expect to see volume grow in line with GDP, with greater upside in the bulk segment and an increased EBITDA as a result of gains in operational efficiency. For the current quarter, we are forecasting similar volumes and EBITDA close to those of the first quarter of 2018, excluding the breakup fee from the rejection of the Liquigás acquisition.

Moving on now to number slide number 7, talking about Ultracargo, where Ultracargo's average storage increased by 1% compared with the fourth quarter of 2017. This was due to greater ethanol handling activities at the Aratu, Santos and Suape terminals more than offsetting the reduction in the fuels handling businesses.

In the quarter, Ultracargo's EBITDA was BRL 40 million, 8% higher than the same period in 2017, influenced by greater average storage and price adjustments at the terminals. For the full year, average storage rose by 5% due to the partial resumption of operations at Santos terminals. EBITDA amount to BRL 178 million, an increase of 44% over 2017, due to greater storage capacity combined with tariff adjustments.

Additionally, 2017 results were still impacted by some residual expenses relating to the 2015 incident. For the current year, we continue to observe a positive market dynamic, maintaining the growth trend in results reported in 2018. In addition, we expect an increase in average storage capacity, following expansion of the Santos and Itaqui terminals.

Let's move on now to slide number 8, talking about Extrafarma. Extrafarma ended the fourth quarter of 2018 with 433 drugstores, a gross addition of 68 in the last 12 months and 27 new stores in the fourth quarter. At the end of the period, 55% of the stores have been opened for less than three years, the same level as the fourth quarter of 2017. Extrafarma's gross revenues in the fourth quarter of 2018 increased by 1% in relation to the fourth quarter of 2017, representing a 5% growth in retail sales. This reflects the results of a larger average number of stores and the annual adjustment in pharmaceutical prices, offset by the residual impacts from the installation of the new retail system in a comparative environment and more pressure.

EBITDA for the quarter was negative BRL 15 million, impacted by the large number of new stores still at the maturing stage. There is a residual effect of the new retail system and more intense competition. In 2018, gross revenues reached BRL 2.1 billion, 8% above 2017, due to greater number of stores. EBITDA in turn was a negative BRL 47 million due to the high percentage of new stores still at a maturing stage. The impact from the stabilization of the new retail system in a more accelerated process of store closures during the year.

In 2019 we expect to reduce our rate of expansion in view of the continuous challenging business environment. The outlook is for increased gross revenues due to the maturation process in the store network, thus reversing the (00:16:20) reserves recorded in 2018.

For the current quarter, we are expecting a growth in revenues, (00:16:28) rollouts in the fourth quarter of 2018 and by a competitive business scenario which remains under pressure.

Moving on now to slide number 9, to conclude I would like to comment on some of the initiatives we have taken in 2018, as well as highlighting our priorities and perspectives for 2019. With an EBITDA of BRL 3.1 billion and net earnings of BRL 1.1 billion, Ultrapar delivered solid results in 2018, although below our expectations. Over the year, we advanced our planned succession process at our businesses, renewing the leadership at

Ipiranga, Extrafarma and Ultragaz. We also strengthened some other senior management positions with the appointment of talents selected from both inside and outside of the company to add skills and experience to our team.

We took important measures during 2013, such as being more selective in our CapEx, focusing on improving the effectiveness in the capital allocation process and then optimizing our working capital. As a result, Ultrapar was able to generate an operating cash flow of BRL 1.4 billion, in spite of the reduced EBITDA, confirming the company's financial soundness.

We are optimistic as for the perspective for improvements in the Brazilian economy, with growth in GDP and greater generation of income and employment. These are factors which contribute directly to the performance of our businesses. Ultrapar never stopped investing in a significant and consistent manner over the past two years, even during the recent recession in Brazil. And this will allow us to pursue a growth trajectory in a solid and sustainable way.

In 2019, we continue committed to operational excellence at our businesses, adopting steps to reduce costs and expenses and for the optimization of working capital. We shall maintain discipline in the allocation of capital, at the same time focusing on our cash generation. We expect to reduce our financial leverage in the coming quarters. This will increase our capacity to invest and to look after organic and inorganic opportunities.

Our outlook at Ultrapar is for an improved results at all businesses. Consequently we expect to see a significant increase in Ultrapar's EBITDA in 2019 compared to 2018, mainly due to the evolution at Ipiranga's results and the recovery in the Extrafarma business. We are convinced that we are taking the necessary measure to create value for our shareholders and all our stakeholders.

With this, I'd like to finish my presentation for today. Thanks for your attention. We can now start the Q&A session.

Q&A

Operator

Thank you. The floor is now open for questions. The first question comes from Frank McGann with Bank of America Merrill Lynch. Please go ahead.

Q - Francis J. McGann

Hi. Thank you very much. Yeah, just to kind of a broad question if I might. The outlook for this year should be helped by the economy and continued recovery from what was obviously a very tough year, particularly at Ipiranga last year. Looking at Ipiranga or fuel distribution in general though, just we've had some new competitors that have come into the market and I was just wondering how you are seeing the competitive environment, the market has – even before that has gotten more competitive over the last couple of years and you've had some opportunities and issues with imports and with Petrobras changing pricing strategy. I was just wondering how you are seeing the overall market right now, but particularly focused on the competitive environment with yourselves competing against not only (00:21:03) and BR, but also what perhaps could be some more stronger new competitors.

A - André Pires de Oliveira Dias

Hi, Frank. Thanks for your question. Well, it is – talking about the new entrants, I'll say that is somewhat too early to tell. I mean, they have recently announced their entrance here through the acquisitions that they've made in 2018. So it's too early to at least verify or observe some different type of behavior.

But there are some specific visions we have that relate to this movement. I think that first one, which is a conceptual one, but I mean a very clear one is that if they are coming to the market, it's because they see a positive market and a market with the capacity to keep on generating value. And those guys, all of them are, let's say, players that do have their principles in terms of value generation and the return on the money that they are investing in Brazil. So it shows from our perspective the health of this market.

In addition to that, I mean, if you think about I mean the, let's say, the type of investments they are making in the fuel distribution business, from our perspective, I mean, those guys are going to basically raise the bar in terms of compliance, in terms of focusing on economic returns, which again I think is overall positive for the market.

Clearly, there is a vision that this market going forward in the next few years, it's going to be a market where let's say international trading is going to be important, that's something that we've been focusing our attention on. We've been, let's say, basically (00:23:17) our structure and strategy related to that. And again, there entrants in Brazil is also a testament on that direction as well. So, overall, we saw that as a positive movement.

Q - Operator

Okay. Thank you very much.

Showing no further questions, this concludes the question-and-answer session. At this time, I would like to turn the floor back to Mr. Pires for any closing remarks – Pardon me. We do have a couple of questions that just joined the queue. Our first question comes from Gabriel Barra with UBS. Please go ahead.

Q - Gabriel Barra

Hi, everyone, thanks for the question. I have only one (00:24:16) on the new criteria of service station. Is that possible to give some more color regarding the difference between the previous methodology and the current one, mainly in the difference of 10% that we have between the numbers and how many gas stations from this difference we could expect to return to Ipiranga network in the future? Thank you.

A - André Pires de Oliveira Dias

Hi, Gabriel. Basically, we've talked about that before, but basically the decision on changing the criteria relates to the fact that showing (00:24:55) of net additions, gas stations that have already been contracted for, but have not been inaugurated as we were doing before didn't correctly show the reality of our network. So, basically what we are doing is that we are considering as – let's say our active network to gas stations that are actively selling fuel in the markets and the growth is going to be related to those gas stations, to those service stations that are inaugurating in a given period in a given year.

So having said that, when you look at the difference between the latest criteria and the current criteria, around one-third of the difference are what you call service stations that are part of our backlog. I mean, gas stations that have been contracted for, but have not been integrated as of yet. I mean, I've talked about that throughout 2018 that we were going to focus our attention, focus our energy in inaugurating gas stations that had already been contracted for with the objective to reduce the backlog. This backlog in the beginning of 2018 was around 500 gas stations. We reduced that by roughly 50% and now the focus is to bring these other service stations back to our network or to our network.

So one-third of this difference comes from this gas station. The other two-thirds is basically some gas stations that have already – they have their contracts expired or there are different types of negotiations with Ipiranga, but they are not currently selling fuel.

Q - Gabriel Barra

Okay, very clear. Thank you.

Operator

The next question comes from Lilyanna Yang with HSBC. Please go ahead.

Q - Lilyanna Yang {BIO 14003234 <GO>}

Hi, André, thanks for the opportunity. I have a question on capital allocation. I wonder where your thoughts are on Ultrapar expanding investment in infrastructure, logistics assets, meaning via activations, if you see the opportunity (00:27:09). And also on a related question, I wonder if from a portfolio management standpoint, looking at your cost, your distribution business, the transportation one or even thinking about specialty chemicals and pharma, if you would consider saving up capital in some of these segments and pretty much dedicate more, it's not only capital, but it's management time towards the fuel distribution segment, where returns seems to be much better and where the growth also seems to be I don't know, maybe more interesting?

A - André Pires de Oliveira Dias

Hi, Lily. Basically, well, talking about logistics infrastructure, yes, this is a very important focus of attention for Ultrapar I'd say 2019 and going forward. You obviously are following the developments here in Brazil. We see that we expect that we might have an interesting opportunities in terms of logistics, infrastructure investments over the next few years. This is not only important to Ipiranga, but also very important to Ultrapar. We are expecting a more favorable environment from now on in terms of, let's say, potential auctions in ports, potential auctions in infrastructure, that is something that is core to our business and where we operate very well. I mean, if you look at the results of Ultrapar over the last 12 months, you're going to see how much this business has improved, the type of returns that this business has and we believe that we might have some interesting opportunities in the next few years. I'm talking about the next two to three years.

But clearly this new administration have shown a more – let's say, a more focus on infrastructure which I think can be very positive for us. As for your second question related to, let's say, capital allocation or portfolio management, basically the way we see and we've been spending a lot of time and energy in having a strategic planning process that is integrated among the five businesses, clearly if you look at the fuel distribution business, it is a business that generates or have been generating more cash, more return for us in the last few years. We expect that this will continue. But the other business, all of them have very interesting opportunities going forward. And we believe that we are in a moment where we can see the turnaround of this platform, focusing more on profitability rather than the growth per se.

We see Oxiteno reversing let's say to a positive trend after a very difficult 2017, so it was really a very good year. We finalized the CapEx in our plants in Texas. And from now on we believe that we're going to start reaping the benefits of this investment and basically executing a, let's say, a very positive commercial policy there to start generating more value.

Ultragaz, it's a still business where we've been extracting better returns even with – ours is a mature market. And I talked about this Ultracargo already. I mean, it's a very good – it is in a very moment from a tiny point of view in Brazil.

So management has been focusing a lot of attention now in this business, but obviously proportionally it is very important that we show a turnaround on the Ipiranga's business, which we are very confident that it is already happening.

If we look at the environment in the first quarter of 2019, it only confirms the expectation that we had for the year as a whole. So it strengthens our conviction, and in fact if we think about volumes for fuel distribution, first quarter has been better than what we were expecting in the end of last year.

Q - Lilyanna Yang {BIO 14003234 <GO>}

Okay. Thank you.

Operator

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

A - André Pires de Oliveira Dias

Okay, everyone. Thanks for the participation. We hope to see you all again when we report our first quarter results next May. Thank you very much. Have a good day.

Operator

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