Q2 2009 Earnings Call

Company Participants

- Andre Covre, CFO and IR Officer

Other Participants

- Unidentified Participant, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to the Ultrapar's 2009 Results Conference Call. There is also a simultaneous webcast that maybe accessed through Ultrapar's website at www.ulta.com.br, where the slide presentation is available for download. Please feel free to flip through the slides during the conference call.

Today with us we have Mr. Andre Covre, Chief Financial and Investor Relations Officer, together with other executives of Ultrapar.

We'd like to inform you that this event is being recorded and all participants will be in a listen-only mode during the Company's presentation. After Ultrapar's remarks are completed, there will be a question and answer session. At that time further instructions will be given. (Operator Instructions). We remind you that questions, which will be answered during the 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 will turn the conference over to Mr. Covre, who will present Ultrapar's results in the quarter and discuss about perspectives. Mr. Covre, you may now begin your conference.

Andre Covre {BIO 15233513 <GO>}

Thank you very much. Good morning. Good afternoon. It's a pleasure to be here with you today to comment on another quarter of strong results for Ultrapar as well as to talk about our outlook for the next two quarters.

I have here with me my financial staff as well as the Directors of Administration and Control of each one of our four businesses, which will help me answer any questions you might have.

Before we start, I would like to draw your attention to slides 3 and 4. I guess as if you hadn't had enough disclaimers, I just wanted to highlight that this two slides contains some important criteria adopted in the financial and operating information that we released in this quarter and are included in this presentation.

We have basically two important messages. First on slide 3, is that the quarterly information of 2008 already follows the new accounting principles allowing direct comparability with quarterly information of 2009. However, as a consequence, the quarterly information of 2008 differs from the key figures that represents and reported [ph] that under respect of earnings results when the old accounting principles were still in force; in another words preexists with [ph] the laws 11,638 and 11,941.

The second message on slide four, is about acquisitions that we have made -- recently closed. Second quarter '09 information does include Uniao Terminais results, as we did in the Fourth Quarter and in the First Quarter. But also now for the first time, we have consolidated Texaco's results into Ultrapar's financial statements as of starting 1st of April.

With that let's move to the main highlights of the quarter on slide number five. We are very pleased to report strong EBITDA growth this quarter. It is the twelfth consecutive quarter that represent EBITDA growth and is the third consecutive quarter since the beginning of economic crisis in September. I believe that highlights the resilience of our businesses as well it's possible due to the investments that we have made in the last several years.

Revenues reached almost BRL10 billion in the quarter, a consequence of Texaco's consolidation, but also growth in all business units. EBITDA grew by 28% compared to Second Quarter '08, reaching BRL321 million also growing in each one of our four business lines.

Net earnings in the quarter amounted to BRL93 million, above the First Quarter of the year, but lower than the Second Quarter of '08, and I'll remind you that our net debt and the level of depreciation expenses increased during the last 12 months, both as a result of investments in organic expansion, which came on stream a few months ago as well as the Texaco and Uniao Terminais acquisitions.

Due to such investments, net debt increased from BRL421 million at the end of June '08 to BRL2.6 billion at the end of March '09, when we finished [ph] with the acquisition of

Texaco. However, since March we have already reduced our net debt position in about BRL200 million through the cash generation of our businesses. And have lowered our leverage ratio of net debt to EBITDA for last 12 months of EBITDA from 2.3 times in March to 2 times in June.

The strong results and the strong cash generation presented in the first half of the year allowed the maintenance of the dividends for the first half of the year at the same level as last year. Dividends amounted to BRL119 million, a 65% payout over the first half '09 consolidated earnings, representing also an annualized dividend yield of 3% over the average share price through the first half of the year.

Now as I mentioned in this quarter, we have also began to consolidate Texaco's results starting effectively to manage the business. We were very happy to focus on realizing the expected benefits according to our acquisition business plan. We'll talk a little more about the implementation of this plan and in particular, an update of an estimated results later in this presentation.

Talking about the performance of each business unit, let's start with Ipiranga on slide six. Now, in order to provide you with a better understanding of the Ipiranga performance in a comparable basis, we have included this quarter an analysis about the results we estimate Ipiranga would have obtained, excluding Texaco's results as well an estimated Texaco's standalone results.

Likewise, in order to allow the understanding of Texaco's recurring performance, we have excluded from its Second Quarter results the expenses with the brand-switching of Texaco service stations to Ipiranga, as well as with integration of the operations, both which are of temporary nature related to the implementation of the business plan.

Now if you look on the left side, which show the information about Ipiranga in volumes excluding the Texaco's figures, which we define here as Texaco ex; -- Ipiranga ex-Texaco. The sales volume in the Second Quarter was in line with the Second Quarter of '08 despite the less dynamic economic environment this year, directly affecting diesel consumption.

On the other hand, the combined sales of gasoline, ethanol and natural gas for vehicles also known as Otto Cycle, continue to present strong year-over-year growth of 8%, driven by the increasing fleet of light vehicles and the car [ph]. It is also driven by improvement in the legislation and inspection of ethanol sales; and third, by the recent investments in new and brand-switched service station.

About each one of these drivers, starting with the first one, the light vehicle fleet in Brazil continues to grow basically at a same pace as last year, which is estimated -- official data has not been published yet, but is estimated at 7 or 8% growth over 2007.

In the Second Quarter of '09, the effect of certain tax breaks, which have continued to be present and have been in existence late last year and the gradual return of credit availability for financed purchases contributed to a record 752,000 new light vehicles licensed in the period up, 4% compared to Second Quarter of '08, which was already a very largely expended comparison base. In the second, but in the second aspect, we continue to witness reduction in the level of informality in the ethanol markets due to networks [ph] implemented to improve legislation and fiscalization in 2008.

The share of ethanol sold by the Sindicom numbers compared to the total ethanol market increased once again to 61%. And I remind you that not too long ago that percentage was about 50%. The third important driver of sales growth in the Otto cycle were investments in new service station and the brand switching of service stations carried out by Ipiranga in the last 12 months. These investments contributed importantly to the growth of 8% in our volume, which were inline with the 8% growth in the overall percent of market, but above the 6% growth in the South and Southeast regions of Brazil, which were the regions where Ipiranga ex-Texaco operated.

Finally on the right side of the slide, you can see that the consolidation of Texaco sales volume. The total sales volume amounted to 4.6 billion cubic meters in the Second Quarter of '09 about 51%, compared to previous year, brining Ipiranga to a new level of size and scale, which will allow series of important benefits as you probably even know, and we will discuss in a moment.

Moving out to slide seven, where we show Ipiranga's financial performance and following the same logic of the previous slide. And the short and on the left side, we present the Ipiranga's EBITDA ex-Texaco, which totaled BRL162 million in the quarter, up 5% compared to the same period of '08. The increase is largely related to the variations on prices and costs of ethanol, with a positive influence from the improvement in legislation and inspection, and consequent reduction on the informality level, evidenced by the higher market share of the Sindicom numbers in relation to the total market.

In the chart, in the middle, on the middle and on the right, we demonstrate that with the consolidation of Texaco, the new benchmark of recurring EBITDA in the respected margin for the combined business. Non-recurring expenses in this quarter amounted to BRL28 million; BRL21 million of which related to the conversion of Texaco service stations with Ipiranga brand as already anticipated in the last quarter; and BRL7 million related to the integration of the operations.

As a consequence, Texaco's EBITDA, excluding non-recurring effects was BRL38 million, which combined with Ipiranga ex-Texaco's EBITDA totals BRL200 million, up 30% year-over-year. Finally, on the side right, we present the recurring EBITDA margins of Ipiranga and Texaco. The first bar, the Ipiranga ex-Texaco EBITDA margin was BRL53 per cubic meter, higher than the average margin of BRL50 per cubic meter in 2008. In addition, Texaco's margin excluding the non-recurring effects, which BRL24 per cubic meter, higher than the BRL20 per cubic meter observed pre-acquisition.

Well with all of that combined, it corresponds to a recurring EBITDA margin of about BRL43 per cubic meter, which is Ipiranga's new EBITDA margin level after the consolidation of Texaco. I draw your attention to this consolidated EBITDA margin, because as we have events with the integration of Texaco, we have all used [ph] the ability to consolidate, to separate Ipiranga and Texaco's results as we did in this quarter.

Moving out to slide number eight. I'd like to give you a brief update on the implementation of our business plan during the last four months since we have started to manage Texaco. As I previously mentioned, the consolidation of Texaco resulted in a significant increase in the Ipiranga's operational and financial scale and in a larger and denser service station network that increased from almost 3,300 -- 3,500 service stations prior to acquisition to approximately 5,500 stations now straight throughout Brazil.

In addition, the Texaco acquisition places Ipiranga in a much better position to grow the business beginning our expansion to the Midwest, North and Northeast regions of Brazil where a few consumption has been growing, faster than the national average. Furthermore, the nationalized coverage that we have now are same [ph] the acquisition of Ipiranga, brings us new commercial opportunities, which already showed some results around this quarter with 13 new clients in the large consumer segment that required a larger footprint.

Regarding now the integration process, since the beginning of our management of Texaco on April 1, we have been working simultaneously in two work streams. The first is the integration of operations where a critical step was completed on August 1, with the integration of Texaco's information systems into Ipiranga's and Ultrapar's. As a consequence of that, we have been able now to start operating our fuel distribution business in a single IT system, allowing us to begin capturing a relevant portion of increasing operating scale during the next two quarters.

In this work stream, we're also now working on consolidating from a corporate standpoint, from a legal standpoint Texaco and Ipiranga another important step in our business plan, which is expected for late November, early December. After completion of this step, we will be operating our fuel distribution business in a single organizational and corporate structure.

While at the same time, in parallel in the work stream of implementing Ipiranga's business model and acquired network, we have expanded the process of converting Texaco service station to the Ipiranga brand, a process that is securing at a faster pace than we have originally projected.

By the end of June, 651 service stations had already been converted with expenses of about BRL21 million registered in the Second Quarter. Until yesterday, the number of converted stations had risen to 830 service stations, which represents 83% of the estimated one 1,000 service stations to be converted in 2009.

In the same period, 178 convenient stores were also converted to our branded AM/PM convenient store, representing approximately two-thirds of the convenient stores that we have acquired with Texaco.

We estimate that the integration process will be fundamentally completed to the beginning of the year, including the transfers obtained and the joining operations of distribution structures in some areas. All leaving [ph] the conversion of the remaining service stations, especially in the Midwest -- Northeast regions of Brazil to be carried out.

With all these initiatives underway, our plan continues to be achieved in two years, the EBITDA margin in the combined business that Ipiranga ex-Texaco has today. I remind you that the EBITDA margin of the combined business ex-non-recurring events in the Second Quarter was BRL43 per cubic meter. The Ipiranga margin ex-Texaco during the first half of this year was BRL53 per cubic meter and within two years from closing or since April this year, we inspired to bring the current margin that we have obtained now with the consolidation of Texaco to the level of Ipiranga standalone that is about BRL53.

Now let's look onto Oxiteno in slide number nine, volume increased by 10% comparing to previous year, due to the start up of expansions in the Fourth Quarter of the year, and the process of replacing imports. In the local market, sales grew by about 6% as the result of good performance in the specialty chemicals sold to the cosmetics, detergents, and agrochemical industries, markets to which the volumes from the expansions are primarily directed. In this quarter, we also saw an increase in the sales of glycols, which is largely a consequence of reduced spot sales in the Second Quarter of '08. In the foreign markets, in the export markets, sales volume grew by 19% mainly due to the start up of our larger production facilities.

Important to remind you, that up in the entry of these new capacities, the shares of sales to the foreign market is expected to initially grow as the domestic demand for Oxiteno products grow, and they tend to grow at a ratio of two to three times the GDP, where we'll redirect our sales from exports into domestic markets where our profitability is stronger. This cycle is part of Oxiteno's strategy while its key [ph] production capacity ahead of domestic demand, operate always at 100% or as close as possible to maximum and sell the surplus into foreign market.

Regarding earnings, Oxiteno's EBITDA for this quarter totaled BRL29 million up 10% from Second Quarter of '08. The increase in Oxiteno's EBITDA is the result of the 10% increase in sales volume and weaker Real in this quarter, but largely -- both aspects were largely offset, but across the realization of inventories with higher costs, higher historical costs than its equipment replacement costs. The fact of the difference between historical and replacement costs was estimated at about BRL35 million, Second Quarter of '09.

Like we did in the First Quarter, we have continued to work in the Second Quarter on the reduction of our inventory levels, which with a year to-date reduction of a BRL177 million and that has allowed us to return to the level of inventories that we had at the end of June of 2008.

Moving now to Ultragaz on slide 10, volumes sold reached 401,000 tons this quarter, a 2.6% decline from Second Quarter of '08, in light with the market variation. In the bottled segment, Ultragaz sales volumes amounted to 281,000 tons almost stable compared to previous year. Such volume stability in the bottled segment as in previous quarters is the result of both the resilient demand in this segment as it is a good of first necessity and also certain commercial institutes implemented by the Company, including the start-up of operations in certain niche geographical and broader [ph] markets.

In the bulk segment, the reduction was -- we saw a reduction of 7% in volumes due to lower industrial activity in the Second Quarter of '09 and a temporary consumption of 4,000 tons by a client in the large bulk segment in the Second Quarter of '08. Regarding earnings, we were able to see once again the positive effects of the recovering gross margins to which the operational efficiency programs implemented in the last 12 months contributed decisively resulting in a 21% increase in gross mark -- gross profit, and 36% growth in EBITDA comparison to Second Quarter of '08. In absolute terms EBITDA reached BRL74 million in the Second Quarter of '09, despite the reduction in sales volume in the bulk segment.

I'd like to take a moment to give you a little bit more color on Ultragaz operational efficiency business programs that I just mentioned. The root [ph] of these problems is related to the fact that behind the current stability of the LPG market is a highly dynamic retail market, where habits and preferences of consumers do change from time to time, allowing opportunities for new sales channels and adjustments of the Company's infrastructure to the new methods of delivery.

For example, in the recent past, the new sales channels have increased in importance and in consumer's preference, especially sales by telephone and sales that utilize coupons. In addition, the sales using electronic means of payment. The growth for these sales channels do allow some opportunities to increase profitability to review our processes and structures. For example, our resellers have now more safe channels to operate allowing therefore a big reduction of management tools per channel, largely in drawing a parallel like fuel [ph] management in the mainstream retail activity.

In the consequence of this, customer service improves, our reseller attains stronger profitability through the utilization of the most appropriate composition of volume and price per channel, and our stocks in our volumes and profitability at Ultragaz also benefit. Another good example is the alignment of the logistical infrastructure to new retail [ph] channels. For example, with the growing share of telephone sales, the delivery must be faster, so we now require a lot less a lot fewer trucks and a lot more light vehicles for the deliveries.

To sum up, the program guideline is a new management model for the reseller network and channels, which evolved and evolves among other initiatives then through a reduction of new commercial operational management tools, particularly for our resellers, the alignment of logistics infrastructures to the reseller's channels and the redesign a resellers qualification program show that they can be well-educated well-prepared to operated in the environment of more complexity, but also more opportunities.

In the slide 11, let's talk about our logistics business Ultracargo once again presented a positive progression in its earnings, with a 67% increase in volume and a much bigger increase in the EBITDA. The increase in volume is the consequence of the consolidation of

Uniao Terminais, but also the expansions that we did in Aratu terminal since 2008 and a higher frequency rate at the Santos terminal.

In the transportation segment, total kilometers traveled decreased as it did in the First Quarter, due to a lower level of economic activity and through Ultracargo's decision to reduce its presence in the packed cargo segment, increasing the profitability per kilometer traveled. EBITDA reached BRL28 million this quarter more than three times previous year, once again, due to the results and synergies from the Uniao Terminais acquisition and the higher volumes of operations in the other terminals, particularly in Aratu and Santos.

This is the fourth consecutive quarter-over-quarter growth in Ultracargo, with a 17% growth in its EBITDA, compared to the First Quarter of '09, in which we have already consolidated Uniao Terminais. I also highlighted to you that in the Second Quarter Ultracargo's EBITDA margin reached 32% a new level of margin, compared to the 13% obtained in the Second Quarter of '08.

Well enough of the past, let's talk a little bit about the future, our priorities and expectations for the next few quarters. Starting with Ipiranga, our focus for the next few quarters shall remain to be integrating Texaco in order to capture the gains from the increased operational scale and the nationwide coverage.

Overall opportunities to execute the activities on the two work streams that based [ph] the business plan of execution of Texaco. In one hand, integration of acquired operations along the realization of economies of scale; and on the other side, implementation of Ipiranga's business model in the acquired network, particularly the brand-switching process of the remaining 170 stations with all the 2009 target.

Definitely, we'll remain alert to capture the benefits from the growth of the combined volumes of gasoline, ethanol, and natural gas vehicles in the market. Such growth is derived from the increased light vehicle fleet in Brazil, which was close to about BRL25 million -- 25 million vehicles in 2008 and continuous to grow basically at the same pace of last year.

In fact, the fleet growth that we have seen so far in 2009, already allow us to have the expectation of relevant growth in the combined volumes of gasoline, ethanol, and natural gas for 2010. Regarding the short-term results, we estimate that Ipiranga sales volume in the Third Quarter, including Texaco will present a similar year-over-year growth, compared to the Second Quarter, in other words, around 50% as order of magnitude.

Regarding EBITDA, as we advance an integration of operations, recurring consolidated EBITDA margins are expected to move towards Ipiranga ex-Texaco's recent margins, which in the first half of 2009 was BRL53 per cubic meter. In the immediate quarter, in the Third Quarter, we estimate that the recurring consolidated EBITDA margin will present a positive evolution in relation to the BRL43 per cubic meter presented in the Second Quarter. I remind to you however that with the integration full speed ahead, we expect, we estimate that we'll have about 25 million non-recurring expenses during the Third Quarter.

At Oxiteno, our attention continues to be towards the commercial initiatives to replace imports and opportunities arising from economic recovery, which should result in year-over-year growth in sales volume in the Third Quarter, Otto [ph] we have seen in the Second Quarter.

Such stronger volume growth and where the inventory alignment process [ph] is substantially finished, we estimate at this moment that EBITDA in the Third Quarter will be higher than the one we've presented in the Second Quarter. However, I'll remind you that this expectation reflects current exchange rate and raw material price levels.

At Ultragaz, we had seen at the beginning of this quarter a slightly better evolution [ph] in volumes mainly in the bulk segment. Excluding the one-off effect of the 11,000 ton consumption by a client in the large bulk segment last year, volumes are likely to remain stable in relation to the Third Quarter of '08. We will remain focus on our operational efficiency programs, which combined with the commercial initiatives in some niche markets, should allow us or allow us to expect for the Third Quarter, a phase of impact that looks [ph] similar to that presented this year so far.

At Ultracargo, we couldn't expect anything different than another quarter-over-quarter EBITDA growth, which will be for the fifth straight quarter of growth for local academy [ph]. Looking over further, with the Uniao Terminais integration substantially completed, and having captured benefit of both those estimated in our initial business plan. We're now redirecting our resources, expanding our existing terminals, while we do have already more than 20,000 cubic meters scheduled to start operations during the next six months.

Lastly, we will continue our specialty of cash flow focus aiming at reducing our net debt level with the growth of our business and lower investment levels for this year. Our investments for this year so far are 41% more than the first half of '08, consistent with expansions of Santos [ph] that is being cashed and our focus on cash flow generation. With that, I conclude what we have prepared for you in this presentation, and I'm available for any questions that you might have. Thank you.

Questions And Answers

Operator

(Operator Instructions). Your first question comes from the line of Michael Holme of Altima Partners [ph].

Q - Unidentified Participant

Hi, there. First of all, congratulations on another great quarter. The question I have is when I looked towards the analyst estimates, you seem to be beating EBITDA, but not beating net income. And part of that has to do with obviously lines below the EBIT line. Just wondering if you at the net debt level, you're seeing greater working capital needs and that might be driving a higher need for net debts or possibly just higher interest charges your costs have [ph] gone up or possibly your accelerated goodwill amortization and maybe it's a combination of those, if you can maybe just provide a bit more clarity on that, Andre, I'd appreciate it. Thank you.

A - Andre Covre {BIO 15233513 <GO>}

Thanks, Michael. It's a pleasure to have you with us again. In terms of our internal plans, or levels of indebtedness and net income, we are at plan. We are not experiencing anything different than we have expected internally. I recognize however that over the last two years, Ultra has change quite a lot. From, for example, growing a company, what kind of a company that didn't have any net debt, for a company that does have varying levels of net debt over the next few quarters. We have also invested quite a lot and made acquisitions, which has changed the levels of depreciation. The acquisitions have also made some effects on the levels of income tax expenses and I think all of that together has made in this beginning, in this first moment more difficult for analysts overall to forecast in the net income. I think that will go away very rapidly, because we're reaching a new level, again a new steady state of depreciation of income tax and so on. And my expectation is that I think that will become easier to project for the investor community than it was during this quarter.

Operator

(Operator Instructions). Your next question is a follow-up question from Michael Holme of Altima Partners.

Q - Unidentified Participant

Thank you. I just wanted to confirm one number. I think you indicated that going forward you think that the Real EBITA per cubic meter and called it new Ipiranga could reach levels of BRL53. I just wanted to, if you could please confirm that number, I'd appreciate it. Thank you.

A - Andre Covre {BIO 15233513 <GO>}

That is correct, Michael. The entire rational over the acquisition of Texaco was to bring to EBITDA margin levels to the one of Ipiranga. In other words, that we within three years. In other words, that we would be able to operate than large business with the same metrics and efficiency, at least that we already operated at Ipiranga. Now, the Ipiranga margin has improved on the back of things that we have doing -- done in the Company. The first half of the year was BRL53 per cubic meter; and therefore, we do aim have to the combined business at least at 53 when they integration process is all finished in about 24 months from close.

Q - Unidentified Participant

Okay. Great. Thank you very much.

Operator

(Operator Instructions). At this time, you have no other questions. I'll now turn the call back over to management for closing remarks.

A - Andre Covre {BIO 15233513 <GO>}

Well thank you very much to you everyone for your presence. We remain optimistic about our businesses. In the next quarter -- next few quarters, we have integration of Texaco, we'll have the vast, and [ph] there is a lot of benefits to be introduced. But we still have some benefits to capture in the Uniao Terminais acquisition and some expansion now on the way in Ultracargo. In Ultragaz, we have the market that is operating under normal conditions with a focus on quality and profitability, and we have our internal operational efficiency programs that will enable us look the future with greater expectations. And finally, at Oxiteno, we do have volumes growing and growing faster than they have so far; and therefore, overall, in our businesses, we are optimists. We expect to have you on the next conference call so that we can share with you the positive results that we expect to have. Thank you very much.

Operator

Thank you. This concludes today's Ultrapar 2009 Results Conference Call. You may disconnect your lines at this time.