Q2 2011 Earnings Call

Company Participants

- Andre Covre, CFO, IRO

Other Participants

- Christian Audi, Analyst
- Gustavo Gattass, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen. At this time, we would like to welcome everyone to Ultrapar's Second Quarter 2011 results conference call. There is also a simultaneous webcast that may be accessed through Ultrapar's website at www.ultra.com.br/ri, where the 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 would 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. (Operation 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. Covre, who will present Ultrapar's results in the quarter and discuss about perspectives. Mr. Covre, you may now begin the conference.

Andre Covre {BIO 15233513 <GO>}

Good morning. Good afternoon, everyone. It's a real pleasure to be here today with you to discuss our performance in the Second Quarter. We are particularly pleased, as we complete in this quarter our 20th consecutive quarter of earnings growth of Ultrapar.

Before we talk about the results, I'd like to draw your attention to some information included in slide number 3, highlights to criteria adopted for the financial information including in this presentation.

As established by the CVM, the adoption of IFRS became mandatory in the financial statements for the year 2010 onwards. And therefore, the figures in this presentation are compliant with IFRS.

Moving to slide 4, this slide attempts to bring context to our earnings progression, showing our economic operating environment. As you can see in the graphs presented, Brazilian GDP continues to grow, but at a slower pace. In our field, this is a consequence of a more adverse international economic environment, and the successive increases in interest rates, aimed at controlling rising inflation.

Economic slowdown has had a lower impact on sectors more directly linked to consumption, mainly as a result of favorable conditions in the labor market. For example, the consumption of durable goods presented strong growth. Sales of light vehicles increased 10% in the first half of this year, compared to the same period last year.

At the other side, the high level of interest rates and the Brazilian economic growth have been contributing to the increased inflow of funds to the country, and therefore, strengthening of the real, which finished the quarter 11% stronger than the average exchange rate of the same period of 2010.

Slide 5, let's talk about our main highlights in this quarter. We believe that reporting 20 quarters of EBITDA growth does not happen by chance. We're talking five complete years of quarterly growth, which happened through different economic cycles.

For example, our earnings increased even during the most critical period of financial crisis in late '08, early '09, demonstrating the resilience of our businesses in periods of economic slowdown.

At the other side, EBITDA and earnings grew by 24% and 74% in 2010 respectively, when the Brazilian GDP presented a strong growth of 7.5%, demonstrating that our businesses are leveraged on the growth of the Brazilian economy.

This growth, which is resilient and continuing for the last five years, reflects the consistent planning and execution of our strategy, always focused on value creation. Our EBITDA totaled BRL503 million in the quarter, up 8% in relation to last year. Such strong EBITDA --

such EBITDA growth contributed to net income of BRL215 million in the quarter, 12% higher than last year.

This good performance, coupled with the sound financial position of the Company, allowed a dividend payment of BRL252 million, equivalent to BRL$0.47 per share, representing a 3.5% annualized dividend yield on the average Ultrapar share price of the first half of 2011.

Another important highlight in the Second Quarter was the approval of the new corporate governance structure in the Shareholders Meetings held on June 28. Upon the approval of the transaction, we started to work on the necessary steps to convert the preferred shares into common shares, and becoming a part of Novo Mercado. These events will take place in a few days' time, on August 17, and on the same day, the new bylaws will become effective. Everyone will have to say goodbye to ticker UGPA4. They will become UGPA3, which means that the shares are common voting shares.

Moving now to slide 6, to comment on performance of each one of our business units. In this quarter, as previously expected, volumes continued to present a positive progression, with an 8% growth over Second Quarter 2010. This volume growth was higher than the 3% market growth, and it is a consequence of investments made to expand the network and capturing market from the unbranded gas stations.

The volumes sold of fuels for light vehicles grew by 7% over the same period last year. This growth is derived from two factors. Firstly, the growth of the light vehicle fleet, which we estimate to have been around 8% in the period. This was partially offset by an increased share of gasoline in the sales mix.

Second factor was increased investments made to expand the network in the North, Northeast and Midwest of Brazil, investments that have allowed a growth above the market. That includes the acquisition of DNP concluded in late 2010, as well as the conversion of unbranded service gas stations and new service gas stations.

The growth in the fuels for light vehicle in gasoline equivalent mix, meaning, taking away the fact of the change in mix between gasoline and ethanol, was 11% over Second Quarter last year.

Our diesel volume grew by 10%, as a result of the economic growth and investments to capture new clients. With the benefits of volume growth, and consequent increased operating leverage, combined with increased share of gasoline and sales mix, Ipiranga's EBITDA amounted to BRL308 million in the Second Quarter of 2011, 15% higher than last year. This has led to an EBITDA margin of BRL57 per cubic meter, higher than the BRL54 per cubic meter in the Second Quarter last year, and in line with the margin of the First Quarter.

For the current quarter, we expect trends to continue. Our estimate at this moment is a volume progression similar to the one we saw between first -- Second Quarters, based on the same growth drivers that we have seen so far.

And finally, we expect EBITDA margin per cubic meter to have the same level as the one we had on the Second Quarter.

Moving on to our other distribution business, Ultragaz, in slide 7, we posted an increase of 2% in volumes over Second Quarter last year, the growth obtained both in Bottled and Bulk segments, and in line with market growth. EBITDA amounted to BRL79 million, a small 5% decrease in relation to last year, as a result of the effects of inflation on costs and expenses, and the startup of two new bottling facilities, the stake of Espirito Santo. These bottles facilities are currently in a maturing process, and therefore, do not generate the underlying benefits.

For the Third Quarter, we expect a continuation of the scenario we saw in the Second Quarter, with similar volume progression, and similar level of profitability.

Coming to Oxiteno on slide 8, the volume sold in this quarter decreased by an overall 13%, mainly as a result of higher spot sales of glycols in the Second Quarter of last year, and the destocking process in Oxiteno's customers due to the economic slowdown.

Despite of the decrease in sales volume, and the real 11% stronger, we had excellent results in the quarter, better even than the indications we had when we released the First Quarter results. In the beginning of the Second Quarter, when we had our last conference call, the scenario indicated that the good conditions experienced in some sub-segments during the First Quarter were about to gradually slow down in the Second Quarter. However, it didn't happen in the quarter, and it was one of the main drivers of the great Oxiteno performance, leading to an EBITDA of BRL18 million.

Looking into the Third Quarter, in the domestic market, we begin to see a lower effect of the adjustment on our customers' inventories, and therefore, we expect now stable volumes in the domestic market, compared with the volumes of the Third Quarter.

For the sales outside of Brazil, mainly exports, we expect still a decrease over the last year on the Third Quarter, part as a result of the economic, global economic slowdown, and part as a result of the stoppage at the Camacari unit for a period longer than expected. As we have already announced -- we had previously announced, certain units at Camacari stopped this quarter to allow the conclusion of the last phase of our capacity expansion plant.

Regarding the EBITDA for the current quarter, the slowdown of the excellent moment [ph] we had in the First Quarter of 2011, instead of having the expected gradual effect in the Second Quarter, it is now having a very accelerated and sharp effect in the Third Quarter. This accelerated effect, this accelerated decrease, also has some effects on our inventories, especially raw material inventories of the units in Camacari that are stopped for a longer period than expected.

Therefore, Oxiteno's margins, in dollars, which were above a normal level in the Second Quarter, are expected to be lower than normal level in the Third Quarter.

Talking now about our Storage Facilities business, Ultracargo, we had a record level of 95% utilization of average storage in the quarter, 8% higher than in 2010, Second Quarter 2010. This is due to the increased handling of products in the Suape and Santos terminals.

In relation to our results, Ultracargo's EBITDA was 8% higher than Second Quarter last year, as a consequence of the average storage, which was 8% higher as well. Our results would have been even stronger, because the benefits of the average storage growth were partially offset by the effects of the sale of the in-house logistics, solid bulk storage, and road transportation business in the end of the Second Quarter.

For the quarter underway, we expect earnings progression stronger than the one we had in the Second Quarter, as in the Third Quarter, we will be comparing with a normalized quarter in which we did not have any more the businesses that we sold.

Coming to the last slide, I'd like to share with you a longer term view of the businesses beyond the current quarter, and also talking about the perspectives of the economic environment that I presented at the beginning of the conference call, and the way it interacts with the profitability of our business.

At Ipiranga, investments made and under implementation for the expansion of the distribution network will continue to drive the volume growth of fuels for light vehicles above the market growth. In addition, even with the recent trend of lower economic growth, we have solid reasons to believe in the continuity of the fleet expansion as a consequence of the number of light vehicles that have been added to the fleet.

July, year to date, almost 2 million new vehicles were licensed in Brazil, for a fleet of slightly below 30 million vehicles. This already allows us to envision the fuel market growth for the year 2012, even if a more severe crisis was to come.

At Ultragaz, investments in expansion in the Bulk segment should reflect in new clients, and therefore, higher volumes for the segment.

In the other side, in the Bottle segment, even with more adverse economic conditions, it will be little affected, due to its very resilient nature.

Oxiteno concludes in this quarter an important investment cycle. This will contribute to higher volumes in the next few years, and increase production flexibility. A consequence, Oxiteno will be able to optimize its production according to the demand of different segments it serves, and it will benefit from the growth of the Brazilian market in the coming years.

Ultracargo will continue to capture the results from the investments in expansion, particularly in the Suape terminal, which is expected to start operations in September, adding 26,000 cubic meters to the storage capacity of the Company. We still have expansions underway in the terminals of Santos and Aratu.

Well looking at an even longer period, I would like to highlight some of the (inaudible) provisions of our new corporate governance structure, which includes the conversion of our preferred shares into common shares on a 1-to-1 ratio, and our participation in the Novo Mercado, with new bylaws that attempt to incorporate all the best elements in corporate governance available in the United States, Brazil, and Europe.

We designed this new corporate governance to deepen the alignment of interests, something that has been the basis of our value creation mentality, leading to very careful planning and execution of our strategy.

Additionally, the new structure provides an increased investment capacity, and allow us to pursue even more ambitious projects. This will contribute to the continuity of our value creation path, aiming at repeating in the future the total shareholder return of 22% a year that we have presented since the IPO in 1999.

Thank you very much for your attendance and your patience. I look forward to any questions you might have.

Questions And Answers

Operator

Thank you. The floor is now open for questions. (Operator Instructions). The first question is from Gustavo Gattass of BTG. Go ahead, please.

Q - Gustavo Gattass {BIO 1702868 <GO>}

Hi, guys. I just had a follow up question from a conversation on a previous call. But I was just wondering, could you elaborate a little bit on this change in margins in Oxiteno? Effectively, what's -- what the components are, if it's basically lower prices, higher costs, just higher costs associating to having, I don't know, more of a -- or, less of an operational leverage, and effectively, how you see it playing out for next year. Is this something that could have a negative impact, or is it much more technical about just going back to the adjusted margin that you guys were looking for?

A - Andre Covre {BIO 15233513 <GO>}

Well first of all, thanks for your attendance, again. It's always good to have you with us, Gattass.

Q - Gustavo Gattass {BIO 1702868 <GO>}

A pleasure.

A - Andre Covre {BIO 15233513 <GO>}

The margins in Oxiteno are passing through a moment where we had some very good things, and these things are getting reverted. So they mean nothing about structural margins, structural future, sustainable margins. In short, it is just two effects.

First, as it happens from time to time, supply and demand of certain products gets tight. If you are in a position to supply, you sell as much as you can in that segment, the overall mix improves.

That, we had on the First Quarter. We had, on the Second Quarter, and that imbalance in supply and demand, going away. And we should go back to normal margins.

Now, we're going to be below normal margins on the Third Quarter, because when that imbalance is corrected in a very fast pace, which is happening now, and your plans are stopped for a longer period than you imagined, you have also an inventory effect, mainly in this case, it's mainly raw materials. That's why margins will be lower than they -- again, a, quote, normal margin.

None of these things are structural. They are situational, they will happen from time to time, and we will make always our attempt to capture the best of it, enough to have any of the negatives of it. The negatives come, basically, from having to stop the plants from time to time, something that we will have to do less frequently from now on, because with expansion programs, every time you do one in one plant, you have to stop it. So we have had many stoppages on the last two years. We'll have a lot less, or, a lot fewer going forward, because the expansions are now finished.

Q - Gustavo Gattass {BIO 1702868 <GO>}

Okay. But let me just understand, then. The mechanical drivers here, if I got it correctly, were -- you're probably seeing a lower market price for the product that you're selling in the Third Quarter. And given that your costs are pretty much flat, because of having your plants stopped because of inventory, you're seeing a margin compression because of pricing. Is that the correct way of thinking about it?

A - Andre Covre {BIO 15233513 <GO>}

That is the correct reason -- that is the correct way of thinking, and that is the fact that causes margins to be lower than normal.

Q - Gustavo Gattass {BIO 1702868 <GO>}

Okay. All right, perfect. Thank you.

Operator

The next question is from Christian Audi of Santander.

Q - Christian Audi {BIO 1825501 <GO>}

Thanks. Hi, Andre. A couple of questions. The first one is a very quick one. I know on Oxiteno, I know, as you explained in the Portuguese conference call, imports are not significant in the segment, because of the specialty nature of your products. But can you give me a sense of what import percentage plans [ph] were of the market in the Second Quarter, and how that number changed versus the First Quarter?

A - Andre Covre {BIO 15233513 <GO>}

Christian, I don't have that information, because that is basically an informational market share in Brazil. What I -- and that's not available in a quarter by quarter basis. I can tell you that on average, we have been 70% to 80% market share on the products that we sell, and the fact of higher imports competing with us, I have to stress again, was very small, because they only affect us on the products where we have -- when you have a bigger component of commodity, lower value added product.

Q - Christian Audi {BIO 1825501 <GO>}

Okay. And the second question is more a big picture one. When you -- in a scenario of the lower than expected growth in the economy, not only globally, but in Brazil as well -- so forget 3.5% growth, it goes below that. Can you rank, among the four businesses that you have, in your view, which ones get the most affected by a more severe slowdown, and which of the four get least affected (inaudible)?

A - Andre Covre {BIO 15233513 <GO>}

Well the parts of our businesses that are directly linked to GDP are, the diesel sales in Ipiranga -- that's about half of the volume. The Bulk segment in Ultragaz, that's about 30% of the volume. The domestic sales of Oxiteno, they're all linked to GDP. Now, that's about it.

Then we have parts of the business that are not linked to GDP, and some of them present strong growth despite the GDP. Some of them are very resilient to GDP. So for example, the other half of volume of (technical difficulty), with gasoline and ethanol is linked to the size of the fleet. And as I have shown, the fleet continues to grow, and continued to grow, even during the period of economic instability.

Okay? (foreign language)

Q - Christian Audi {BIO 1825501 <GO>}

Andre, what growth are you using for the remainder of the year, in terms of economic growth in your budgets, and for 2012, what are your expectations, given all that you're seeing right now in the market, in terms of Brazil and domestic GDP growth, for budget purposes?

A - Andre Covre {BIO 15233513 <GO>}

My crystal ball is not any better than yours, I think, and the consensus of the market. So we don't take views that are different than the rest of the market. But again, to stress, we -- and some (inaudible), the answer that I was giving, we do worry about it. But there is large parts of our business which are not directly linked to GDP. So for example, in Ipiranga, I was saying, about half of the volume is diesel, that's GDP. Half of the volume is related to the continued growth of the fleet. But in profitability, the participation of ethanol and gasoline is bigger than the 50%.

In Ultragaz, 70% of the volume is for consumption of households. Even with the most severe crisis, that doesn't get affected.

Then finally, in Ultracargo, the experience we have is that the Company's volumes grow when the economy grows, because everyone is importing, exporting more goods. And when there is instability, people need to reduce [ph] their inventory, so we have our tanks full.

And we have a great combination of resilience and leverage on the economy, which make us have great performance from the economy as well. That was the example last year. And we also have positive growing results when the economy does not do well.

All of that to say, we don't put great time into determining forecast of GDP. It is an important variable, but it's not a fundamental variable in our business. And as I joked, our crystal ball is not better than the market's crystal ball.

Q - Christian Audi {BIO 1825501 <GO>}

Right. And a very last question, Andre. The Company has changed a lot, obviously, since 2008. But what are the main changes that you think since 2008, when we had a crisis in the market that put pressure across the board? What are the key differences or changes that Ultra has gone through, that it think, better prepare it to deal with a more bearish scenario now in 2011?

A - Andre Covre {BIO 15233513 <GO>}

Well if I had to single out one, it's the --

Q - Christian Audi {BIO 1825501 <GO>}

There has to be more than one, so I just mean, like the main ones, in your opinion.

A - Andre Covre {BIO 15233513 <GO>}

Well starting with, probably, the biggest one, is the fact that we acquired Texaco since then. And that has made our Ipiranga business stronger, with a 22% market share, solidifying its position as the second player in the market. Having better scale, and therefore, stronger, to face even the most severe downturns of the economy.

The other one that I would say is that we are in a financial position even better than we were in 2008. We don't have any important debt maturing within a year. And our average cost of that, currently, is around CPI [ph], which makes our cost of carrying the debt basically zero. So the financial flexibility that we have to weather any very severe crisis is not costing us anything.

Q - Christian Audi {BIO 1825501 <GO>}

Okay. Great. Thanks for the note.

Operator

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

A - Andre Covre {BIO 15233513 <GO>}

Well thank you very much for your attendance. Thank you, Gattass and Christian for the questions. I appreciate, and we look forward to having you with us on our next results, Third Quarter results. Thank you. Have a good day.

Operator

Thank you. This concludes today's Ultrapar Second Quarter 2011 results conference call. You may disconnect your lines at this time.