Q4 2013 Earnings Call

Company Participants

- Andre Covre, Chief Financial & IR Officer

Other Participants

- Felipe Santos, Analyst
- Marcus Sequeira, Analyst
- Tom Ashby, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to Ultrapar's 4Q '13 and 2013 Results Conference Call. There is also a simultaneous webcast that may be accessed through Ultrapar's website at www.ultra.com.br/ri. 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 from 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.

(Operator Instructions).

We remind you that questions, which will be answered during the question-and-answer 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'd like to turn the conference call 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>}

Thank you very much. Good morning, everyone. Or good afternoon, I guess, to the people in Europe. It's a great pleasure to be here with you again.

Today we'll discuss Ultrapar's performance in the Fourth Quarter and full year of 2013, which was another great year for us. To help me here answering any questions you have, I have the officers from all the businesses and the investor relations team.

Before continuing, I'd like to draw your attention to slide number two, where the criteria adopted for the information in this presentation is highlighted, as well as for the information that we published on the last few days.

We'll start now the discussion on Ultrapar's consolidated results on slide number three. We presented in this Fourth Quarter our 30th consecutive quarter of EBITDA growth. The main field for such performance is the strong and consistent investment of the last several years.

As an example, in the last five years, we invested BRL7 billion in our businesses. These investments allowed increased geographical footprint of the Ipiranga and Ultragaz distribution networks, with increasing quality of the resellers and differentiation to clients. The logistics infrastructure was also expanded and now has nationwide reach and increasing capitalarity.

At Oxiteno, we strengthened the focus on specialty chemicals, with greater differentiation and stronger scale. At Ultracargo, we significantly expanded our storage facilities with expanded terminals and wider geographical coverage. For the year 2013, EBITDA grew 21% and net income grew by 20%. With these numbers, we have now reached 15 years of above 20% average annual growth in results.

The earnings growth was accompanied by an increase in profitability. As you can see in the graph on the top right, our return on equity increased from 18% in 2012 to 20% in 2013.

And in spite of the strong investments carried out in the last several years, investments designed to keep the company's growth trends that I mentioned, the earnings growth and the cash generation of our businesses allowed us not only to maintain, but also to strengthen our solid financial position. Financial leverage fell from 1.3 times net debt to EBITDA to 1.2 times at the end of 2013.

Cash generation by our businesses have also allowed us to pay increasing dividends. They total of BRL744 million in relation to the 2013 earnings, a 19% increase over 2012. These facts demonstrate the company's ability to invest in its profit growth and pay increasing dividends without jeopardizing our sound financial position.

This combination of growth with profitability and solid financial position also contributed to generate good returns to our shareholders. In 2013, Ultrapar shares appreciated by 21%, well above the market indexes. In addition to that, the dividends declared represented a 3% dividend yield over the average price in 2013, thus maintaining the level of recent years.

To better understand how we have reached such consolidated results, let's dive into the performance of our businesses, starting with Ipiranga on the next slide. The demand for fuels continues to grow, mainly due to the growth of the Brazilian light vehicle fleets, as shown in the bottom left chart. Even without any growth in car sales in 2013, the fleet is estimated to have reached 37 million cars, a 7% growth, boosting sales of fuels for light vehicles, mainly gasoline, ethanol, and natural gas for vehicles.

On our side, we continued to expand Ipiranga's service station network. We've been doing this through significant investments in opening new service stations and converting unbranded service stations with a geographical focus on the Midwest, northeast, and north regions of Brazil, the fastest-growing regions. We ended the year with 6,725 stations, up 4% over 2012. These investments have allowed the company to grow above the market and obtain an improved sales mix, with increasing sales of -- with -- with increasing share of sales to service stations, also known as the reseller segment.

And it is exactly in the reseller segment where we find the highest potential for our strategy of differentiation through constant innovation and services and convenience, helping to increase the flow at the service station, customer satisfaction, and loyalty. This philosophy of convenience and service has become well-known in Brazil to sell marketing and advertising campaigns. The most famous ones are Ipiranga, "A complete place waiting for you," and "Ask there at the Ipiranga service station." Both of them summarize our value proposition to our clients.

Finally, improvement in reducing the grey market especially in ethanol took place in 2013, bringing benefits to consumer, retailers, and the company itself, in addition to greater tax revenues for the government. A demonstration of this trend is increased share in ethanol sales by the Sindicom companies, as compared to the total market. This share increased from 62% a year ago to 69% in the Fourth Quarter 2013, as seen in the chart on the bottom right.

Such progression walked hand-in-hand with major initiatives for curbing the grey market, such as concentrating the collection of PIS/COFINS taxes, a form of federal VAT in Brazil, for the whole -- for the whole ethanol chain on the production level. Also, the investments that we have made and other branded companies have made in converting unbranded service stations had helped formalizing the markets.

These four factors are key drivers to the evolution of our results. As you can see on the top left chart, our sales volume increased by 7% in the Fourth Quarter, maintaining the growth level of 2013, which was 6%. EBITDA totaled BRL624 million, a 20% growth year over year. Excluding some extraordinary effects listed on the EBITDA chart, we saw a growth of 14%. For the full year, Ipiranga's EBITDA exceeded for the first time BRL2 billion, up 23% over 2012.

Looking ahead, the market trends and our strategy remain the same. And therefore, we can expect more of the same in terms of results. Specifically for the First Quarter, we expect an evolution of volumes slightly better than that between Fourth Quarters. And as a result, EBITDA growth was slightly higher, as well. And here I'm talking referring to the evolution of EBITDA between Fourth Quarters, excluding the one-off effects.

Moving out to Ultragaz on slide five, in the Fourth Quarter, we saw sales volume grew by 2% over Fourth Quarter of last year. The growth is concentrated in the bulk segment, which increased by 3% year-over-year, as a result of investment in new clients, mainly in the residential buildings and small; and medium-sized companies. These segments provide for an improved sales mix.

EBITDA followed the trajectory of growth this quarter with an increase of 16% year over year and ended the year with a 14% growth over 2012. In addition to the increased bulk volumes with improved mix, such growth was mainly the result of commercial and cost-reduction initiatives implemented over the last 18 months. Such initiatives include the conversion of some company-owned stores into resellers; increased automation in the bottling facilities; and some changes in freight contracts.

In addition, in the Fourth Quarter, we had re-qualification of a larger number of LPG bottles, offsetting part of this growth as we had anticipated in the Third Quarter conference call. The larger re-qualification results from an analysis have showed that, at this moment, it's better to do the re-qualification of existing LPG bottles, thus reducing the need to invest in the acquisition of new LPG bottles in the future.

For the fourth -- for the current quarter, we have seen here in Brazil exceptionally hot weather for our summer, as opposed to the freezing weather in the Northern Hemisphere. And hot weather impacts LPG demand negatively. In addition, the level of costs with the re-qualification program is expected to continue in the First Quarter. And as a result of these two elements, we expect as an exception no growth in the EBITDA of the First Quarter.

Now, in to Oxiteno. Sales volumes totaled 179,000 tons in the Fourth Quarter, a 6% year-over-year growth in specialty chemicals, which is the central part of the strategy and keep its profitability. The performance of Oxiteno in specialty chemicals is based on the development of new technologies and innovations, ensuring greater profitability, lower volatility, and great proximity to customers.

The volume of specialty chemicals in the domestic market grew 5%, a multiple of about two times the estimated GDP growth for the year in Brazil. Such growth was made possible by the presence of Oxiteno in segments of high-growth demand, such as cosmetics and detergents, coatings and agrochemicals, and also by the conclusion of an important capacity expansion cycle in 2011. In the foreign market, the growth in specialty chemicals was 8%, due to the acquisition of a plant in Uruguay in November last year.

The overall growth in specialty chemicals was offset by lower glycol sales with the scheduled stoppage at the Camacari petrochemical complex. As a consequence, Oxiteno's consolidated sales volume in the Fourth Quarter was 4% lower year on year, but however with a much richer sales mix. During 2013, total sales volume increased by 2%, with the growth in specialties partially offset by the lower sales of glycols in the second half of the year, due to the mentioned stoppage at the Camacari petrochemical complex.

Oxiteno's EBITDA in the Fourth Quarter grew 47%, closing the year with a 25% increase over 2012. Relevant drivers for such growth were the weaker real and the richer sales mix, with a larger share of specialties. These effects were partially offset by expenditures related to the start of operations in the United States and Uruguay.

Looking ahead, we see in this quarter the same trends that we saw in the Fourth Quarter. And therefore, we expect specialties volume and EBITDA to grow at a similar pace to the one we saw in the Fourth Quarter.

Moving to slide seven. Ultracargo's effective storage grew 9% in the quarter and 13% in the year. This trend is primarily due to the acquisition of the Itaqui terminal in August 2012 and to investments in expansions that resulted in increased handling products in Suape and Aratu. EBITDA grew 6% in the quarter and 10% in the year, mainly as a result of the increased volumes.

This was partially offset by expenses mostly related to some strategic and growth projects. Looking to the First Quarter, the one-off expenses of the Fourth Quarter should not repeat, and therefore, we expect a growth in EBITDA similar to the one we saw for the full year of 2013.

Moving now to slide eight, let's talk a little bit about our plans and expectations for Extrafarma during this year. We concluded a transaction on January 31st as expected. In the shareholders' meeting, we had three-quarters of the capital represented, and the transaction was approved by 99.8% of the capital.

Following that, we started executing the business plan that underlines the acquisition. It's a plan focused on organic growth with accelerated pace of new store openings. Extrafarma opened some 40 stores in 2013, and we plan to open, after the period of transition and preparation, at least 130 stores per year and, as a consequence, to reach an EBITDA of approximately BRL300 million in five years.

Under this plan, 2014 is a year of preparation, as we have mentioned when we announced the transaction. Such preparation is divided in two fronts. First, the operational integration through Ultra, which includes, for example, centralizing the finance functions in Sao Paulo like we have for the other businesses and implementing EVA for variable compensation goals already in 2014.

Some activities have actually been concluded already. For example, we're already closing the daily cash management of Extrafarma at our centralized treasury in Sao Paulo. And we expect to conclude all steps of the integration in the first half of this year.

The second front, which is already also underway, consists of adapting the structure of the company and redesigning its processes to allow for larger-scale of store opening and, therefore, for faster expansions. Among the initiatives implemented already on this front I'll highlight the creation of a team exclusively dedicated to expansions of stores and business development.

This process of preparation for faster growth will impact 2014 results. Basically, to reach the EBITDA of BRL300 million in five years, we will incurring expenses that will bring 2014 EBITDA levels to lowered levels than 2013, as per provided for in our operation business line. In other words, in 2014, we will see a year of investment, the fruits of which -- which will be seen in the coming years in an accelerating pace.

Separate from this, it's our expectation to have relevant revenue growth in 2014. And specifically for the First Quarter, we expect a 15% revenue growth.

Moving now to the last slide on page nine, I opened today's presentation talking about investments that have driven our growth so far. I'd like to close talking about how investments should continue to pave the way for similar evolution in the future.

Our investment plan for 2014 totals BRL1.5 billion, in large part targeting expansion. At Ipiranga, we plan to invest BRL886 million, primarily in growing our distribution network and am/pm and Jet Oil franchises, focusing on the midwest, northeast and north regions of Brazil. In addition, we will invest in expanding our logistics infrastructure to meet the growing demand in an efficient way.

At Ultragaz, investments in expansion will be concentrating in building a bottling base in Sao Luis, in the state of Maranhao, and also in expanding the UltraSystem, our LPG small-bulk business, with the view of capturing clients focused on the residential building segments and also on the small and medium company segments.

Oxiteno plans to invest primarily in concluding the capacity expansion in Mexico, which will add 30,000 tons per year in capacity starting during this year. In addition, we have a potential expansion in the production capacity and possibly in United States.

For Ultracargo, we plan to expand the Itaqui terminal also in Maranhao, and that should be operational next year. And finally, for Extrafarma, investments will focus on maintaining the pace of opening drug stores and potentially accelerating already at the end of the year and expanding the distribution infrastructure.

We expect these investments will allow increased scale and improved market positioning, and differentiation, and as a result, keep us on our trajectory of the last 15 years.

I'll conclude here what we have prepared for today. Thank you for your attention, and we are available for any questions you may have.

Questions And Answers

Operator

Ladies and gentlemen, thank you. The floor is now open for questions. (Operator Instructions). And our first question comes from Marcus Sequeira from Deutsche Bank. Please go ahead with your question.

Q - Marcus Sequeira {BIO 4622700 <GO>}

Hello. Good morning, everyone. Good morning, Andre. I have two questions. The first one, I'm just trying to kind of establish a relationship for your market share gains in Ipiranga and how much points of EBITDA can you get only from things of scale. I don't know you could help me with that.

Then a second question is more general. You know, how the economy has been performing since you last spoke about your EBITDA expectations for this year on a consolidated basis, I'm just wondering if -- you know, how the economy has done, if that changes your plans to invest in Ipiranga -- probably not, because you just reiterated that -- but just how your expectations of EBITDA growth in '14, if they have changed at all? Thanks.

A - Andre Covre {BIO 15233513 <GO>}

Hi, Marcus, thanks for your questions. On the first one, if you look at the last three years, we have grown between 1% and 2% more than the markets. And that's probably a pace that we will continue for some years, given the opportunity of growing the network, especially in the target areas of the north, northeast, and midwest.

The benefits of growing faster than the markets go hand-in-hand with growing volumes overall. And that's number -- that's the benefit number one, providing operating leverage. I'm sure you are familiar that contribution margins is around BRL115 to BRL120 and EBITDA margin is given around BRL80 for the last 12 months. And the difference between the two provides for operating leverage.

Second, growing faster than the market allows us to improve our mix. We are growing and growing the percentage of sales done through the gas stations. And it's in that segment where we have the bigger opportunities for differentiation. So growing factor than a market, in summary, allows for operating leverage, allows for better sales mix.

Finally, the investments in expansion help reduce the informality in the market, particularly -- and that's a very difficult element to quantify, but I think we can see the projection that we had this year on reducing the informality, and flight switching was one of the things that contributed to that.

As to the economy, our perception is that things have not changed. This year's economy tends to be very similar to last year's economy, which causes, though, no changes in expectation. And I know you are familiar with the fact that the economy has a mild effect on our businesses. And therefore, even if we have an important change in the economy, the impact on our business would be much smaller than in most other companies. So the planned investment is maintained, and the expectations for the year that we announced in November are also maintained.

Q - Marcus Sequeira {BIO 4622700 <GO>}

Thank you very much. Just one quick, like, last question -- just I know it's still very early to talk about it, but there is some questions about possibly talk of rationing happening in Brazil this year. If that was the case, I would say that -- I would assume that only Oxiteno will be -- or Oxiteno would be the most affected, but -- while the rest would not be affected, because they are all either not very electricity-intense or they are also -- they deal with energy, as well. So is that the correct assessment?

A - Andre Covre {BIO 15233513 <GO>}

Electricity accounts for 2.5% of variable costs of Oxiteno. And therefore, a shortage of electricity will probably generate initially higher costs, which have very small impact on us. (inaudible) more serious than in the case of blackouts, for example, then that would have a direct impact in Oxiteno's plant as it had in the past.

We unfortunately have had blackouts in the northeast regions in the last few years. And what that means is that the company is stopped for a period of time, and it's turned back when there is electricity and supply of raw materials again.

Q - Marcus Sequeira {BIO 4622700 <GO>}

Thank you very much.

Operator

Our next question comes from Felipe Santos from JPMorgan. Please go ahead with your question.

Q - Felipe Santos {BIO 16391255 <GO>}

Hi, Andre. Hi, all. Yes, just some -- some questions. The first one is relative to the Marcus question before. Last year, you didn't reach the CapEx level that you announced at the beginning of the year. Do you think that this -- this CapEx for this year could be -- could be having the same thing? I mean, the CapEx could be too big -- too big executed in that yea) in which you have elections, World Cup, and et cetera?

A - Andre Covre {BIO 15233513 <GO>}

Well there are three reasons -- three reasons we didn't spend the capital budget for last year. First, in Ipiranga, we -- in three of the expansions of storage facilities, we are delayed to licensing.

In Oxiteno, we delayed the potential expansion in Pasadena for this year. In Ultracargo, there was an investment to be made in Suape for adapting the terminal for a particular client, and the client decided to do the investment themselves in our facility. So these things explain the CapEx below last year.

For this year, the expectation is to make the BRL1.5 billion capital expenditure. We don't have a reason to believe that we will have selected elements like last year not to spend it.

Now, we are on 31st of February. CapEx budget is a living thing. It's a limit approved by the board. We don't have to spend it. And therefore, we exercise our judgment over the year attached to the timing of the various things.

Q - Felipe Santos {BIO 16391255 <GO>}

Great. And my second question is regarding the expansion in -- the expansion of the Ipiranga to the unbranded and white flag stations, is there a limit of volume that you're looking for each gas station? Or you look a location -- I mean, how is the company's strategy for these conversions of the gas stations? I mean, is there any further (inaudible) that we don't going to look at? Or do you don't have this kind of concern?

A - Andre Covre {BIO 15233513 <GO>}

Firstly, there are three elements to look for -- location; size; and quality of the reseller. And it's through those three lenses that we select our business partners. Given the number of white flags in Brazil -- and that they have today through 33% of the market, I believe that there's ample opportunity for many years to continue to do this.

Q - Felipe Santos {BIO 16391255 <GO>}

Okay, that's perfect. Thank you, so much.

Operator

(Operator Instructions). And our next question comes from Tom Ashby from BKA. Please go ahead with your question.

Q - Tom Ashby {BIO 20354633 <GO>}

Thank you. Could you comment further, please, on inflation expectations for 2014? Then a related question. Do you expect any increased use of hedging in 2014? Thank you.

A - Andre Covre {BIO 15233513 <GO>}

The inflation that we have factored into our budget is for 2014 -- is very similar to the one that we saw in 2013. And in terms of hedging, Oxiteno is in dollarized business and, as a consequence, we carry some debt in dollars, matching, therefore, cash flows and that in the same currency, and we don't expect to change the level of that relationship.

Operator

(Operator Instructions). And at this time, in showing no additional questions, I would like to turn the conference call back over to Mr. Covre for any closing remarks.

A - Andre Covre {BIO 15233513 <GO>}

All right. Well thank you very much. This was it for 2013. Happy 2014. We hope to see you in a few months when we talk about the First Quarter. Thank you.

Operator

Thank you. This concludes today's Ultrapar's 4Q '13 results conference call. You may now disconnect your telephone lines.