Q2 2016 Earnings Call

Company Participants

- Andre Pires, Chief Financial and Investor Relations Officer

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to Ultrapar's 2Q'16 Results Conference Call. There is also a simultaneous webcast that will 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 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 that 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. (Operator Instructions)

We remind you that questions which will be answered during the Q&A session may be posted in advance in the webcast. A replay of this call will be available for one week.

Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of Ultrapar Management and on information currently available to the Company.

They involve risks, uncertainties and assumptions because they relate to future events and therefore depend on circumstances that may or may not occur in the future.

Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of Ultrapar and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I'll turn the conference over to Mr. Pires. Mr. Pires, you may now begin the conference.

Andre Pires {BIO 17698724 <GO>}

Thank you and good morning everyone, and it's a great pleasure to be here with you again. Today we will discuss our performance in the second quarter of 2016. Some of my colleagues from our business divisions and the IR team are also here to help me answering your questions.

So starting with slide number 3, I would like to start our discussions today with an overview of the last three months. Starting with our numbers, we would like to highlight another quarter of EBITDA growth for Ultrapar.

This is the 40th consecutive quarter of year-on-year growth. Those 10 years of EBITDA growth reflect the soundness and the resilience of our business model and our team's ability to overcome challenges and seize opportunities, especially considering the challenging economic environment.

Net revenues grew by 4% and our consolidated EBITDA by 19%, both year on year. Our net earnings grew 11%, driven by the EBITDA growth and impacted by the increase in our net financial expenses.

We continued to deploy our CapEx plan and reached R$366 million of investments in the quarter and R$659 million in the first half of the year, increasing our scale, enhancing our operations and focusing on our differentiation initiatives.

We note that our CapEx budget for the year is R$1.8 billion, although the final number for the year could eventually be lower considering the effects of the exchange rate on Oxiteno investments.

We have been growing our results and our investments on a year-on-year basis and our return on equity reached 19%, maintaining a strong balance sheet. Our net debt-to-EBITDA ratio reached 1.3 times by the end of the second question of 2016, in line with our historical levels.

We also announced the dividend payment of R$0.80 per share for the first semester. This represents a 2.4% annualized dividend yield over the average share price in the first semester and a 58% payout ratio considering our earnings year-to-date.

In addition to our quarterly results, we have recently announced two strategic moves in line with our focus on growth and value creation. The first one was the acquisition of Alesat announced in June.

We are very enthusiastic about the benefits it should bring to our shareholders, consumers and resellers.

A quick update on this transaction; 99% of the shareholders present at Ultrapar's extraordinary shareholders meeting held last week approved the acquisition and 70% of the Ultrapar capital was represented at the meeting.

This was one of the precedent conditions that we fulfilled. The approval by the antitrust agency CADE is another precedent condition for the acquisition. We filed a notice with CADE and the transaction is now under review.

Until CADE's approval, Ipiranga and Alesat remain as competitors conducting their business as usual.

Another transaction we announced recently was the joint venture with Chevron, encompassing the lubricant business of both companies. Ipiranga will own 56% of the JV.

This transaction expresses our continuous focus on generating value from our assets base. The partners are well aligned [ph] about the growth potential of this market and the benefits of this transaction.

Both are experienced companies in the sector that have quality assets in commercial, prudent [ph] sales structures that complement each other. We are very excited with this transaction, which is also subject to CADE's approval.

Moving now to slide number 4 to discuss Ipiranga; Ipiranga's volume was 8% lower than the second Q of '15, repeating a downward movement of the last two quarters.

Fuel sales volume for light vehicles, the Otto cycle, fell 11%, reflecting the deterioration in unemployment rates and disposalable income. Both factors have been prevailing over the average fleet growth, estimated at 2% in 2016. Diesel volume fell 5% year on year, also reflecting the economic downturn.

The Company's action was keyed to mitigate the adverse effects of the economic crisis. We continue to invest in the expansion and strengthening of our service station network, which will accelerate in the second semester, typical for annual investment cycles.

In addition to the expansion of our service station network, we maintained our differentiation strategy based on innovation through products, services and convenience.

Since the second Q of 2015, Ipiranga has expanded am/pm, the largest convenient store network in Brazil, by 219 stores and now they are present in 27% of our service stations.

We have 1,950 Ipiranga service stations with am/pm stores throughout the country. We also have the largest bakery network of the country with 542 units in place, up 38% year on year. We also highlight our 1,486 jet oil franchises, which showed a 10% growth year on year.

Our loyalty program, Kilometers de Vantagens, is the largest in Brazil is a success story in the strategy of differentiation designed by Ipiranga. Today, this program has close to 22 million participants, growing 15% year on year and has become a key relationship and loyalty platform for the Company.

The constant innovation strategy based on services and convenience strengthens our resellers, especially at this difficult economic environment and contributes to greater customer loyalty and satisfaction. This has led to a 25% EBITDA growth year on year, reflecting the same trends seen in recent quarters, including the movement in the domestic and foreign market of fuels.

Looking now for the current quarter and talking about our expectations, I would like to remind that they are not specific projections, but rather trends, levels or order of magnitude in the progression of our results. In Ipiranga, market trends and our current strategy are maintained, therefore, our expectation is an evolution similar to what we have seen in the second quarter in volume and EBITDA.

Moving now to Oxiteno in slide number 5; total sales volume in Oxiteno dropped 5% year on year, reflecting the economic downturn still present in the second quarter.

Specialty chemicals volume fell 7% year on year. Under the current scenario of falling specialty chemicals volume in the domestic market, Oxiteno has been increasing sales of commodities, seeking better capacity utilization and cost dilution of the plants. This results in a 5% growth in glycols sales.

In this quarter, the BRL was weaker than in the second Q of 2015 on average. On the other hand, it has moved in opposite directions. We saw sharp Real appreciation in 2016 versus a depreciation in 2015.

These ups and downs were positive for Oxiteno last year and negative in 2016 due to a mismatch in the exchange rate for revenues and costs, which has an effect on overall margins.

In terms of raw materials, we experienced the same trend, cost fluctuations were favorable in 2015, especially for the ethylene, and negative in 2016, mainly for palm kernel oil. Under this scenario, Oxiteno's EBITDA reached R$117 million in the second Q of 2016, a 42% decline year on year.

In the current quarter, we've seen a few signs of stabilization and recovery of the economy, which led us to a more positive view regarding volumes since the comparison base also becomes more favorable since the economic environment started to deteriorate from that point on in 2015.

However, the exchange rate levels and international prices of raw materials are expected to continue to impact our margins in the quarter.

Now moving to Ultragaz in slide number 6; Ultragaz sales volume grew by 4% over the second Q of 2015. In addition to the resilience in the bottled segment, we implemented commercial initiatives to add new resellers, leading to 1% of volume growth year on year.

In the bulk segment, we grew our volume by 10% compared to the second Q of '15. This performance is a result of investments made to capture new customers, especially industrial clients and small and medium businesses, mitigating the negative impact of the economic downturn.

In addition to capturing new customer and resellers, Ultragaz extended initiatives towards differentiation and better offering of consumer convenience. Some examples are innovation in order to -- innovation in order entry and payments systems for LPG bottles such as Ultragaz Connect and Vale Ultragaz.

In the bulk segment, we have deployed the prospecting and installation approach for bulk LPG that reduces this process time by one-third, which we call UltraPronto [ph]. All these initiatives add quality and value to our customers and resellers.

In the second Q of 2016, Ultragaz EBITDA reached R$108 million, an increase of 49% year on year. This result was achieved due to an increase in sales volume, commercial initiatives to capture new customers, resellers and by a number of differentiation strategies as mentioned before.

Our expectation for the current quarter is a level of volumes and EBITDA similar to the previous quarter.

Now, let's talk about our liquid bulk storage business, Ultracargo, moving to slide number 7. We had a 9% improvement year on year in Ultracargo's average storage, mainly explained by the complete interruption of the Santos Terminal in April 2016, while it remained only partially suspended in the second Q of '16.

This improvement was also due to increased handling of fuels in all terminals. Excluding Santos operations, Ultracargo's average storage recorded 5% increase year on year, driven by increased volumes of fuels.

Excluding Santos, Ultracargo's EBITDA was R$26 million in the second Q of '16, stable compared with the second Q of '15.

Consolidated EBITDA for second Q of '16 was R$42 million, R$91 million above to the second Q of '15 EBITDA, mainly due to lower expenses related to the fire and to revenues from insurance advances received in this quarter.

In the second quarter, we had extraordinary income via cash advances from the insurers in the amount of R$30 million as well as R$12 million of fire related expenses.

For the current quarter, we should see similar performance for terminals excluding Santos. For the Santos terminal, we will continue with the second phase of the decommissioning process and the insurance adjustment.

Before moving to Extrafarma, I would like to make an update on the Ultracargo operations in Santos. The decommissioning process is ongoing including the removal of equipment and structure damage by the fire.

Throughout this process, the final report determining the cause of the fire should be issued. Our expectation is that we should be ready to obtain the licenses to operate the terminal by the end of the year and to resume operations in 2017.

Moving now to slide number 8 to talk about our retail pharmacy business, Extrafarma. Before going to the results, I would like to highlight an additional stat for Extrafarma.

In June, we officially launched our new brand reinforcing the attributes of trust and proximity in the relationship with customers. The new identity and the new store model are an important part of the initiatives to provide customer convenience and better shopping experience. The new stores are being opened under this new concept and the existing stores will be remodeled to adapt to the new standard.

Extrafarma ended the second Q of '16 with 280 stores, an increase of 46 stores compared to June 2015. 20 stores were opened during this quarter and one store was closed, showing a more accelerated expansion pace.

This means 7% increase in the number of stores quarter on quarter and 20% year on year. Stores with more than three years of operation represent now 40% of our network.

Extrafarma revenues grew by 14% year on year, especially due to a 24% increase in retail revenues excluding mobile phone sales as a result of the increased average number of stores and the 15% growth in same-store sales excluding mobile phones.

The improvement in retail pharmacy management standards and the annual price adjustments of medicines set by the pharma sector regulator contributed to the top line growth despite the deterioration in the economic scenario that led to a 38% drop in mobile phone sales.

EBITDA reached R$12 million in the second Q of 2016, 37% growth year on year, mainly due to a 24% growth in retail sales excluding mobile phones and to management standards improvements, partially reduced by the larger share of maturing stores and the deterioration in the economy.

For the current quarter, our expectation is an evolution similar to what we have seen in the second quarter in store openings and in EBITDA growth.

Now, going to slide number 9 and before we finish our presentation, I would like to reinforce some characteristics of our business which translate our mid and long-term expectations.

The economic conditions remain challenging, but our business model, which combines resilience and differentiation will continue to be one of the key factors to our growth.

We have seen some signs of recovery in the volumes of our businesses, which encourages our expectations of growth resuming in some segments.

Despite the economic recession in the last two years, we kept investing and we are confident in our business fundamentals. We have been passing through this crisis successfully and we are ready and stronger for the economic recovery.

On the left hand side of the slide number 9, we listed the main business lines or segments with a direct impact of the Brazilian GDP, accounting for approximately 50% of our revenues. On the right hand side, we listed the areas where the other factors are more influencing [ph].

The Brazilian economic performance has an impact on diesel segment at Ipiranga, on domestic sales at Oxiteno and in bulk segment Ultragaz as well as the handling of chemicals at Ultracargo.

Our businesses are also impacted by other factors such as the expansion of light vehicle fleet in connection with the Otto cycles volume at Ipiranga and demographics reflecting in the ageing of the population, which is the main driver for the long-term growth and resilience of the retail pharmacy business.

As the economy recovers, we believe we will capture the benefits of this growth given our organic investments and also from the recently announced transactions.

With that, I conclude the presentation and I'm available for any questions you may have. Thank you.

Questions And Answers

Operator

Thank you. The floor is now open for questions. (Operator Instructions) I'm showing no questions, so I will turn the call back over to Mr. Pires for any closing remarks.

A - Andre Pires {BIO 17698724 <GO>}

Okay. Thank you everyone for your participation and we hope to see you again or to talk to you again with our third quarter results that will be reported in November. Thank you very much.

Operator

Thank you. This concludes today's Ultrapar's 2Q 2016 results conference call. You may now disconnect your lines at this time.