

Q4 2017 Earnings Call

Company Participants

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

Other Participants

- Frank McGann, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to Ultrapar's 4Q 2017 and 2017 Results Conference Call. There is also a simultaneous webcast that may be accessed through Ultrapar's website at ir.ultra.com.br and MZiQ platform. Please feel free to flip through the slides during the conference call.

Today with us, we have Mr. André Pires, Chief Financial and Investor Relations Officer, together with other executives of Ultrapar. We would like to inform you that this event is being recorded, and all participants will be in listen-only mode during the company's presentation.

After Ultrapar's remarks are completed, there will be a question-and-answer session. At that time, further instructions will be given. We remind you that questions, which would 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.

André Pires de Oliveira Dias

Okay. Thank you very much. Good morning, everyone. It is great to be here with you to discuss Ultrapar's fourth quarter results and our consolidated results for 2017. Here with me are the officers from our businesses as well as the Investor Relations team to help answering your questions.

Going to slide number three, before looking at Ultrapar's performance during the fourth quarter of 2017, I would like to highlight some aspects that reflect our outlook for the businesses. Let me begin by stating that Ultrapar concluded one more year of consistent consolidated results despite the persistently challenging business environment.

In our last conference call, we were expecting a more positive second half and this has indeed been the case as shown by the positive evolution in our indicators. Our businesses' resilience, the execution capacity of our teams, the investments made, and the focus on differentiation and innovation have all been instrumental in allowing us to continue in our long-term growth path.

In 2017, we reported consolidated EBITDA of R\$4.1 billion, and net income of R\$1.6 billion. If we excluded one-off effects reported throughout 2017, both of them show stability compared to 2016 even with the challenging environment imposed by three years of recession in Brazil.

The return on equity was 17% and we maintain our financial solemnness, one of the hallmarks of the company which has been cultivated over many years. The net debt to EBITDA ratio has remained at comfortable levels of 1.78 times.

The company has been able to pay increasing dividend, thanks to the consistent performance of our businesses, and our cash generation. Approval was given for the payout of R\$489 million in dividends with respect to the second half of the year and equivalent to R\$0.90 per share.

As a result, dividends declared on profits for 2017 as a whole were R\$951 million, a growth of 5% over the dividend declared for 2016. This represents an annualized dividend yield of 2.4% on the average price of the shares in 2017, and a 60% payout on net earnings for 2017, therefore maintaining the levels of recent years, an indication of our confidence that this good performance will continue.

In addition to the various initiatives and organic investments, we were also involved in two important strategic transactions during the year. The first, in the LPG distribution business was the agreement signed in 2016 to acquire Liquigás. This is still under analysis by the antitrust authority, CADE, with a final hearing expected for next year. We maintain our efforts for the approval.

The second project is the joint venture with Chevron for the creation of a new lubricants company named Iconic, which started to operate in the end of 2017. We are confident of the benefits that these transactions will bring to Ultra and to Brazil.

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We continue to pursue expansion of the Ipiranga service stations, Ultragaz resellers and Extrafarma drugstore networks, as well as the start up in Oxiteno's new Texas-based ethoxylation unit in Pasadena, and the capacity expansion in Ultracargo. In 2018, we intend to continue implementing a robust CapEx plan focused in organic investments. This is indicative of the good opportunities still available for growth in scale and productivity, as well as from modernization of the existing operations.

Let's now move onto slide number 4, on the performance at Ipiranga. As we mentioned last quarter, one of the key growth levers at Ipiranga continues to be the accelerated expansion of our service station network, through which we expect to obtain greater benefits as the service stations reach maturity.

We ended 2017 with 8,005 service stations, a growth of 6% year-on-year, with the addition of 592 units gross and net of 442 new service stations throughout the country. This reflects our focus on the development of an attractive business model for our resellers.

Confirming the recovery trends already seen in previous quarters, sales volume in 4Q 2017 increased by 4% compared to fourth quarter of 2016. Improvement in economic indicators as well as increased new vehicle licensing contributed to growth in total volume notably through a 6% increase in diesel volumes sold during the period. The 1% increase in sales to the Otto cycle volumes still reflects persistent levels of unemployment, although these are expected to improve during the course of 2018.

In addition, it is important to highlight that the number of new vehicle licensed in January 2018 was 22% better than the same period of last year, which is a good indicator of the Otto cycle's performance for 2018. Total annual volumes sold at Ipiranga was 23,458,000 cubic meters, stable when compared to 2016, but showing a positive progression in the second semester.

Ipiranga's differentiation through the combination of innovation and offer of convenience is a strategy aligned with an accelerated expansion of the network. A good portion of the almost 600 service stations opened in 2017 already bring differentiation initiatives, which strengthen our brand name with our resellers and consumers.

In 2017, our strategy was reflected in an investment in 250 new am/pm franchises, now present at 30% of the network and in addition to the 141 Jet Oil units, 179 bakeries, and a 116 beer caves besides Iconic, the joint venture with Chevron in lubricants.

With that, Ipiranga posted a consolidated EBITDA of R\$3.1 billion in 2017, a year-on-year growth of 2%. In the fourth quarter, the EBITDA was R\$895 million, a 4% increase compared to the same period of last year. This can largely be explained by to higher sales volumes and to the strategy of innovation and convenience at our service stations even with the challenges related to the volatility in the cost of fuels.

Talking about this last subject, I'd like to make some remarks. Since the end of 2016, the Brazilian fuel market has been going through changes in its pricing dynamics that

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strengthened the market as a whole. We had three changes since October 2016 which brought over the necessity of tactical adjustments in our business model and lead to greater volatility during this period of settlement. The last modification in December of 2017 reinforces the increased correlation between local and international prices.

We recall that Ipiranga is focused in the organic expansion through accelerating the pace of service station openings. We expect that the strategy has a positive impact on volumes growth for 2018, especially considering the gradual improvement in the economy and in the market as a whole. This will allow Ipiranga to keep growing its results similar to those seen before 2017. For the current quarter, the market is still more challenging than expected, which should impact the level of EBITDA variation in the short-term.

Moving on now to Oxiteno on slide number 5. Oxiteno closed 2017 with a year-on-year growth of 7% in sales volume and reached 790,000 tons by year-end. For the fourth quarter of 2017, the volume was 16% better than the same period 2016 and a record fourth quarter sales at the company. Volume in 2017 was higher than in 2016, both in specialty chemicals as well as commodities. If we break down volumes, there was a 5% growth in sales of specialty chemicals for the year and a 16% growth for commodities.

In the fourth quarter of 2017, the highlight was the increase of 69% in commodity sales, driven by higher prices and product demand as well as scheduled stoppage at the Camaçari plant in the fourth quarter of 2016.

After six quarters of year-on-year decline, Oxiteno's EBITDA amounted to R\$76 million in the fourth quarter of 2017, an increase of 68% when compared with the fourth quarter of 2016, due to higher sales volume. In 2017, Oxiteno's EBITDA amounted to R\$295 million, down 36% year-on-year.

Looking to the months ahead and for the year of 2018, our expectation is that volumes should continue to grow both due to the economic recovery and the start up in the operations of the new ethoxylation plant in United States, expected for the second quarter of 2018.

For the current quarter, we expected similar level of EBITDA, to the ones seen in the same period of last year, excluding the non-recurring effects that we had in the first quarter of 2017. We'll recall that some indicators outside Oxiteno's control have caused significant volatility over the last two years, assuming a certain degree of stability in the same indicators, and taking into account the continuation of growth in volumes, we can expect Oxiteno to report a positive evolution in results for 2018.

Let's now move onto Ultragaz in slide number 6, where sales volume for the fourth reached 426,000 tons, 3% lower when compared to the same period in 2016. In annual terms, volume was slightly down as compared to the level of 2016. In the bottled segment, volume was impacted by price volatility in raw materials as well as fewer business days in the quarter.

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In the bulk segment, a greater volume base in 2016 combined with the migration of some industrial clients to the natural gas segment impacted the comparables for 2017. Together with discipline in cost management along the years, Ultragaz has been successfully developing a more differentiated approach, two initiatives, which delivered greater quality of services and convenience to consumers.

In this quarter, EBITDA at Ultragaz reached R\$52 million impacted by the extraordinary effect of R\$84 million relative to the Cease and Desist Agreement signed with the antitrust authority, CADE, in November of 2017. The agreement totaling R\$96 million to be paid in eight semiannual installments relates to an investigation from 2009 with an impact on EBITDA of R\$84 million and our financial result of R\$12 million.

Not considering these extraordinary item, Ultragaz's EBITDA would have grown 11% compared with the same period 2016. In 2017, Ultragaz annual EBITDA was R\$453 million, a growth of 1% over 2016 and 20% if we factor out the extraordinary effect of the agreement with CADE.

Our outlook for 2018 is for further growth [Technical Difficulty] (00:14:14). For the current quarter, we still see the same effects on volumes and therefore on EBITDA. In the short-term, we shall continue to pursue the approval process on the acquisition of Liquigás which is still pending absolution from CADE with a ruling expected by the end of this month.

Let's now go to slide number 7 to talk about our liquid bulk storage business, Ultracargo. Ultracargo's average storage area increased by 9% compared with the fourth quarter of 2016. This was largely due to increased fuel handling activity in the Aratu and Itaquí port terminals as well as in Santos, where there was a partial recovery in capacity from June onwards.

Average monthly storage utilization in 2017 recorded an increase of 8% compared to the same period in 2016. In the fourth quarter of 2017, Ultracargo's EBITDA was R\$37 million, a decline of 50% year-on-year due to an insurance claim received and booked on the fourth quarter of 2016.

Excluding all the non-recurring impacts related to the fire incident, Ultracargo shows an EBITDA increase of 87% compared to the fourth quarter of 2016. This performance is the result of the average increase in storage handling activity, the partial resumption of operations at the Santos terminal and greater productivity during the period.

Taking the year as a whole, Ultracargo posted an EBITDA of R\$124 million. For the current quarter, we see continued growth in the demand for liquid bulk storage facilities, impacting positively the EBITDA. In this context, Ultracargo's focus will be on efforts to expand capacity and to use the company's leadership position as a growth lever to achieve few more positive results in 2018.

Moving on now to slide number 8, let's talk about our pharma retail business, Extrafarma. Extrafarma saw a 25% increase in the number of drug stores in its network and ended the

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year with 394 stores, a net addition of 79 units. At the end of the quarter, 55% of the stores had been operating for less than three years compared with 45% in the fourth quarter of 2016. These reflects the accelerated pace of network expansion, notably in the case of São Paulo, where nine Extrafarma stores opened in the quarter, maintaining the continued consolidation of the business in the state.

Fourth quarter gross revenue at Extrafarma was 30% higher compared to the fourth quarter of 2016, resulting from the greater average number of stores and growth of 15% in retail sales. It is important to highlight that, in addition to the comparison basis of the fourth quarter of 2016, when retail sales presented a 32% growth, Extrafarma's gross revenues was also affected by a decline in growth of the market as a whole, and a more intensive promotional activities in new regions. For the year of 2017, Extrafarma's gross revenues was up by 18% compared with the market data published by the Brazilian Pharmacy Association, Abrafarma, which reported respective growth 8% in the quarter, and 9% for the year.

The declining growth pace of retail sales, a larger number of maturing stores and a concentration of inventory losses in the quarter led to R\$3 million EBITDA in the fourth quarter of 2017. In 2017, as a whole, Extrafarma's EBITDA amounted to R\$24 million. For the coming quarter, we shall maintain our strategy of organic growth, which will impact profitability on the short-term. The gradual maturing of the stores will drive EBITDA growth for 2018.

With this, I come to the end of what we prepared for you today. We remain with positive perspectives for 2018 despite all the challenges that lay ahead. We see growth in all the businesses along this year and remain optimistic with the economic scenario.

Once again, I appreciate your attention. We can now begin the Q&A session. Thank you.

Q&A

Operator

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

Q - Frank McGann {BIO 1499014 <GO>}

Hello. Thank you. Two questions if I could. One is just on Oxitenio with the Pasadena operation. I was just wondering how you are thinking of that from an earning standpoint in 2018-2019? What kind of contribution should we expect? How rapidly do you see that growing?

And then secondly, in Extrafarma, you mentioned that the gradual maturing of the store should drive EBITDA in 2018. Are we at the point now that the improvement that you have from the stores that are maturing will be more important than the drag that comes from

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new store openings or if not when do you think we get to that point so that we could start to see perhaps a more consistent performance in terms of earnings generation?

A - André Pires de Oliveira Dias

Hi, Frank. Thanks for the questions. First one regarding Oxitenó, there should not be any material contribution from the Pasadena plant for 2018 results, marginal one for 2019. So it's not still not a major contribution, basically just taking a step back when we announced this project, our expectation was that over time this operation would represent anywhere between 15% and eventually 20% of Oxitenó's EBITDA over time, right. And we maintain this expectation, but this is not going to happen neither in 2018 nor in 2019. So the ramp-up is between one-and-a-half years to three years, and after that we expect that the contribution should start to become more important.

For Extrafarma, yes, we believe that gradually the more rapidly maturing stores should start to impact EBITDA positively. So this should allow an important growth of EBITDA for 2018. But obviously this will depend as well on the overall economic activity. We will continue for the next two years or three years to have an important portion of the stores that are still not mature. So this tends to impact the short-term profitability, but over time this impact should become less important. Just keep in mind that 55% of our stores are still not mature, ideally we'd like to see that level below 40%, 30% but it's going to take some time until this happens.

Q - Frank McGann {BIO 1499014 <GO>}

Okay. Thank you very much.

Operator

I am not seeing any further questions. So at this time, I would like to turn the floor back to Mr. Pires for any closing remarks.

A - André Pires de Oliveira Dias

Okay. Thanks everybody for participating in the call and hope to see you again on our call for the first quarter of 2018 results. Good afternoon, everybody. Thank you.

Operator

Thank you. This concludes today's Ultrapar's 4Q 2017 Results Conference Call. You may now disconnect your lines at this time.

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