

Grupo Rotoplas First Quarter 2017 Conference Call

Operator

Good morning and welcome to the Grupo Rotoplas first quarter 2017 results conference call.

Please note that today's call is being recorded and all participants are in a listen-only mode to prevent background noise. Later we will conduct a question and answer session. I would now like to turn the call over to your host for today, Mr. Esaú Gallegos, Grupo Rotoplas' Head of Investor Relations. Mr. Gallegos: Please go ahead.

Esaú Gallegos:

Thank-you, [operator name]. Good morning everyone and thank you all for joining us today. Yesterday we issued our earnings press release after market close. The release can be found on the IR section of the Rotoplas website. As usual, we've provided slides to supplement our discussion. These slides can be also accessed on our website under investor information.

Before we start, let me remind everyone that today's discussion contains forward-looking statements based on the environment as we currently see it and as such does include risk and uncertainty. Please refer to our press release for more information on the specific risk factors that could cause actual results to differ materially. The Company disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, further events, or otherwise.

I'm joined today by Mr. Carlos Rojas, Rotoplas' Chief Executive Officer, and Mr. Mario Romero, Chief Financial Officer. We'll begin our call with prepared comments and then we will open it to Q&A.

I would now like to turn the call over to Mr. Carlos Rojas. Mr. Rojas, please go ahead.

Carlos Rojas Mota Velasco:

Thank you Esaú, and thank you everyone for your interest in our Company. We appreciate your time for joining us this morning.

I am very glad and particularly grateful with all the effort done by our management team, to present today to our investors' community our results for the quarter. As some of you might recall, 24 months ago and given the situation, we were facing at that time in Brazil, we started to shift our strategy emphasis in order to reconfigure our business portfolio toward less government dependent sales. This effort coupled with the successful integration of the companies we acquired over the last year into the Rotoplas platform, has resulted in a strong increase in revenue and higher profitability.

Organic growth was very healthy as the demand for our solutions continued to be strong, mainly in Mexico, Peru, Central America, and Argentina. In these countries, sales of our individual solutions performed particularly well. In Brazil, we started to see some signs of recovery as our sales in this region grew for the first time in nine quarters, driven by the reactivation of several sales' contracts in the government channel. In addition, we continue with our penetration strategy in the US market, slower than anticipate but firm.

As we mentioned during the last conference call, the Company established that government related sales should not represent more than 10% of total consolidated sales in order to reduce volatility into our P&L. In line with this strategy, it is worth to mention that this quarter government related sales accounted for less than 5% on a consolidated basis.

I would now like to share with you several updates related to specific geographies where we operate.

Let me start with the North American Region. In Mexico demand for our individual solutions continued to be strong, driven mainly by our water storage and water flow solutions in the retail channel driven by strong consumer consumption and market share growth. We believe this reflects the strength our brand as well as the innovations we continually offer with our products. In addition, the successful integration of Sytesa, brought higher sales of our integrated solutions with maintenance and more stability into our P&L.

In addition, as I mentioned before, in the US we remain much focused on gaining market share with high quality products, innovation and striving to expand our client base. When compared to the same quarter in 2016, we are proud to say that the number of clients we serve has grown more than 85%.

Finally, in Canada, we successfully completed the acquisition of Sanzfield Technologies Inc., an innovation center that specializes in developing water treatment and water recycling systems. We are confident that with this state-of-the art technology we will be able to leverage our value creation capabilities in the near future.

Following with the South American Region, the company did well this quarter in all of the markets. Argentina did great in the retail channel and benefited for the cross selling

synergies achieved by the acquisition of Talsar. Brazil, as mentioned before, a slow recovery is starting to show and Peru benefited from a higher demand for water storage solutions, mainly because of the impact of the “El niño costero” a climate effect that caused atypical rains and droughts in the region.

I would like to take this opportunity to let you know that our second Annual Integrated Report will be available on our website on April 28th. The Report covers our financial and sustainability-related results for 2016, and it was drafted following the GRI standards. The report includes the most relevant information concerning Grupo Rotoplas, how we operate as well as the description of our sustainability model, which assesses the impact of our products and operations on the threefold aspects of sustainability: economic, social and environmental, all in alignment with the Group's Corporate Strategy towards 2019. We invite you to review our report in the Investor Relations section on the Rotoplas website.

Final, I would like to say that we remain confident that the strategy that we have implemented over the last two years will continue to pay off in the following quarters as it has during this one. We will remain very focus on taking advantage of the opportunities that the water industry offers, and we will do so supported by of our current and dynamic product portfolio of water solutions, the strength of our brand, and our proven capabilities to maintain the business profitability.

With that, let me turn the call over to Mario who will take you through our results.

Thank you very much.

Mario Romero Orozco:

Thank you Carlos, and good morning everyone. I will now share with you in more detail the financials for the first quarter of 2017. As you know, later we will turn the call over to you and we will be happy to respond to any questions you may have.

As we have mentioned, we are pleased that the results of the quarter show a positive outcome for the effort we have been doing over the past years. Our top line recorded a growth of 41.9% quarter over quarter due to higher individual solutions sales in every one of the regions in which we participate and the successful integration of the acquired businesses. When excluding the inorganic sales, the company posted a robust growth of 27%.

In Mexico, we recorded a higher demand for our water storage and water flow solutions, which continues to reflect our leadership position in the market and the strength of our brand. Brazil, as Carlos mentioned, starts to give signs of a path to recovery. The Other Countries division registered an increase in the individual solution's sales, mainly due to higher demand of water storage solutions in Peru given the “El niño costero” climate effect

that caused water scarcity in the region, the cross-selling synergies achieved in Argentina coupled with good work done in the US.

When looking at the business by solutions, the Individual solutions segment grew 33.4% and accounted for 90.6% of total revenue when compared to 96.4% during the first quarter of 2017. When excluding the sales coming from the company acquired in Argentina, the net increase was 26.2%.

As for the sales of integrated solutions, it more than double quarter over quarter, mainly due to the recovery of the government sales contracts in Brazil and to higher sales of integrated solutions with maintenance in Mexico, because of the acquisition of Sytesa. Integrated solutions accounted for 9.4% of total consolidated sales during the quarter, compared to only 3.6% of the first quarter of 2016.

Gross margin decreased 350 basis points; two thirds are the result of the change in the mix of sales, because of the incorporation of Sytesa and Talsar to the portfolio, which have lower margin contribution and the remainder basis points coming from higher resin prices affected by the Mexican peso devaluation.

On the other hand, operating margin increased 70 basis points resulting from better sales and lower expenses, mainly due to a disciplined expense management utilizing the zero base budget approach across the entire organization. Along the same line, EBITDA margin grew 210 basis points mainly due to the increase in sales we mentioned before coupled with the integration of the acquisitions we made last year. Excluding inorganic results, EBITDA margin increased 90 basis points when compared to 1Q16. It is important to mention that during the quarter we registered one-time expenses of \$30M pesos related to the resumption of operations in Brazil coming from the reactivation of the factories to fulfill the rainwater harvesting sales contracts.

It is worth mentioning that EBITDA and Net Profit generation was the highest we have recorded for a first quarter in the history of the Company, proving the effectiveness of the changes we have made over the last 2 years. Finally, all of the above contributed to a net profit margin increase of 80 basis points, while earnings per share for the last twelve months increased 10.3% reflecting a shift in business profitability trend.

Our cash position decreased by Ps. 22 million pesos since December 2016 because of debt amortizations paid during the quarter in the amount of Ps. 74 million, as well as the acquisition of the Sanzfield innovation center in Canada, for Ps. 44.8 million. Our free cash flow during the quarter excluding the acquisition and debt amortization totaled Ps. 93 million.

To conclude, we believe that this quarter's results reflect well on how the Company executes without the volatility generated by government sales. We are confident that the

reconfiguration of our business portfolio with less exposure to government sales, coupled with a continued strong demand and constant efforts towards disciplined expense management within the Company, will allow us to recover and exceed the levels of profitability we have enjoyed a few years back.

As for our 2017 guidance we referred to during our last call, we confirm our goal of reaching double-digit growth in sales and EBITDA on a year on year basis.

I would now like to turn the call over to the question-and-answer session. We will begin by answering questions posed by those of you participating in the Conference Call, followed by questions received via our website. Operator, please go ahead.

Operator:

If you would like to ask a question, please signal by pressing star, one on your telephone key pad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, please press star, one at this time.

We'll go to Adan Rodriguez with GBM.

Adan Rodriguez:

Hello gentlemen. Thank you for taking my questions. Firstly, regarding the restart of certain Brazilian operations, has your outlook of the recovery of the country changed during the first quarter of this year? Additionally, what are your expectations from Brazil during 2017? Thank you.

Carlos Rojas Mota Velasco:

Hello Adan. Thank you very much for your question. Good morning. First of all Brazil, we have some signs of starting some recovery although today we are leaving with very intense competition driven by prices, so our position today is to be not much efforts for trying to have growth for this market is competitive but to be ready for better moments. So, we are just trying to keep all of our capabilities and be ready for better moments.

With the government, they have shown some signs of recovery but not something significant. So, in this year Brazil, we are not expecting, at least anything significant reflected in our P&L, but just to maintain ready for the right moment.

Adan Rodriguez:

Okay, thank you for your answer. Another question if I may. We saw strong performance from the Mexican operations throughout this quarter. Can you give us a little bit more

color of what drove this performance mainly with price increases, volumes, a mix of both, and do you see this performance as sustainable for the rest of the year? Thank you.

Carlos Rojas Mota Velasco:

Yes. Specifically we have a significant growth in our regular portfolio, the individual solutions driven mainly by the drought that we have been suffering, but also by the benefits that were (inaudible) chose to resolve these problems for the consumer. In the Integrated Solutions as we mentioned, we have been able to manage Sytesa and to integrate Sytesa in our Performance Solutions and it starts to reflect in our P&L. (Inaudible) starts to reflect yet in Sytesa, the growth saline protection that we believe we have growth of this opportunity. Yes, we believe this is going to give for the year.

Adan Rodriguez:

Okay. Thank you for your call, and gentlemen have a good day.

Carlos Rojas Mota Velasco:

Thank you Adan.

Operator:

As a reminder, if you do have a question, please press star, one at this time.

We'll go to Pablo Ricalde with Bank of America.

Pablo Ricalde:

Hi. Good morning. Thanks for the call and congrats on the results. I have two questions. The first one is related to expenses related to the start of operations of Brazil. I just want to double check the amount you mentioned of Ps.32 million for the first quarter, and if we should expect more of those expenses during this quarter? That would be my first question.

Mario Romero Orozco:

Yes. Hell Pablo. Thanks for joining us for the conference. Yes, we mentioned Ps.30 million. That was a one timer that we don't expect to be recorded in the first quarter. So, going forward all that is taken so we don't expect to have more of this revamping of our operations in Brazil.

Pablo Ricalde:

Perfect. My second question is on Mexico on the Water Fountains Program. I see that you didn't record any revenues during this quarter. I was wondering if you have started to register some revenues since April?

Carlos Rojas Mota Velasco:

Yes, let me try to explain about the water fountains. First of all, of today we have more than 4,000 water fountains installed. Out of those 2,000—about half of them come from this program that the government started last year with a potential of 40,000 schools with water fountains. We are on the track according in our plans. P&L has reflected only 269 water fountains and we are expecting this year to have leads for 18,000 fountains, and half of them, around 9,000 should be—we should have the leads in the couple next weeks.

Mario Romero Orozco:

More on Carlos, what he mentioned. We recorded sales last quarter, not in 2016 but this quarter we haven't recorded any sales of the water fountains. The main reason is that the process to take all the necessary signatures into the documents is taking a long time, but we think that will be achieved during the rest of the year.

Pablo Ricalde:

Okay. Perfect.

Operator:

As a reminder, if you do have a question, please press star, one.

We'll go next to Ulises Argote with Santander.

Ulises Argote:

Hi, guys. Thank you very much for the call. Just two quick questions. The first one; given the restart of contracts in Brazil and the improvement we've seen there, can we expect to see breakeven in that market probably in the next quarter? What are the expectations you have for this? Then the second once just to be clear, does the guidance that you gave, does it include the acquisitions or is it all organic growth? Thank you.

Mario Romero Orozco:

Hello Ulises, thanks for joining us this morning. Regarding Brazil, yes the goal is to be neutral for the remainder of the year. We think we should be in path to achieve that. On the guidance we gave, we gave it as an overall Company. That includes in organic growth.

Ulises Argote:

Okay. Thank you very much Mario.

Operator:

We will go next to Mason Zhang with Cedar Street Asset Management.

Mason Zhang:

Hi. Thank you. Can I ask, can you shed some light on the one time charge that happened in your Brazil business?

Mario Romero Orozco:

Yes, as mentioned during the call, we have a contract already signed from 2014 for doing some rainwater harvesting devices. Obviously, we all know the story about what happened in 2015 and 2016, and 2017 some of these water solutions have been reactivated, though when we have to go out and hire the people, start to rotate the inventory that we have paralyzed for two years, that is when all these one time charges happen. So, those are charges that either were sitting on the balance sheet or because of hiring new services for people to fulfill these contracts.

Mason Zhang:

So, that charge is associated with primarily hiring costs? Right?

Mario Romero Orozco:

Yes, part of it is hiring costs but also part of it was from inventory being sitting in your balance sheet from the past.

Mason Zhang:

Okay. Thank you.

Operator:

As a reminder if you do have a question, that is star, one.

We will go back to Pablo Ricalde with Bank of America.

Pablo Ricalde:

Hi. Thanks. I have a follow-up question on pricing. I don't know if you can manage from your pricing strategy going forward now that (inaudible) have increased.

Carlos Rojas Mota Velasco:

Sorry, we lost you.

Pablo Ricalde:

No, I was wondering if you could provide your pricing strategy for the rest of year because you mentioned in the press release that you saw higher raw material prices.

Mario Romero Orozco:

Yes Pablo. What we did, is in January we announced a price increase of most of our product lines and that was effective in February and we've been charging better prices from March. That price increase will offset the increase in the FX percentage over the quarter. The increase we did was roughly 5% on the blended mix, and we expect to keep our price point at that level if the macro variables (phon) stay pretty much the same.

Pablo Ricalde:

Okay. Thanks.

Operator:

We have no further phone questions at this time.

Esaú Gallegos:

We want to thank you for your time and your interest in Grupo Rotoplas and hope you will join us again next quarter. Until then we'll be sure to provide you with important updates. Thank you again.