

Grupo Rotoplas Second Quarter 2017 Conference Call

Operator

Good morning and welcome to the Grupo Rotoplas second 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 questions and answers 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 also be accessed on our website in the investor information section.

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 there may be certain risk and uncertainty in such statements. 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 am 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 for our conference call.

We are satisfied with the results we have posted during this quarter, which in addition to the first quarter of the year clearly reflects a change in the trend of the Company's profitability performance. After two difficult years the Company faced, these results confirm that the changes implemented to focus on other channels and solutions to offset the dependence of our sales to government is starting to prove right.

I will now share some business ad strategy updates regarding the regions in which we operate.

In Mexico we continue to experience good demand for our products, the strong consumer consumption observed in the first half of the year combined with more innovative products translated into double digit organic growth. On the other hand, the incorporation of Sytesa's results into Rotoplas has complemented the portfolio very nicely, bringing P&L stability and potential for future growth. In this regard, the integration of Sytesa is moving according to plan and still on the process of capturing commercial synergies in the foreseeable future.

With regard to the water purifying fountains program, this quarter we have booked income related to these solutions. As of June, we have completed the installation of more than 70% of the assigned purifying fountains, and we expect the next cycle of bids for new water purifying fountains to take place in the coming months.

Turning to Brazil, the challenging economic and political situation continues, however, we were able to record an increase in sales of sustainable solutions as a result of the reactivation of sales contracts to the government. Going forward we will continue to focus on keeping tight control on costs and expenses while taking advantage of the opportunities that the market presents to recover profitability in the short term. These opportunities might include partnering with local players in the near future.

The Other Countries division have performed positively during the first half of the year; The results of Talsar, the company we acquired during the first quarter of 2016 in Argentina, have been satisfactory. Its integration has allowed us to generate cross selling synergies. On the other hand, Peru continues with strong demand mainly of water storage and water treatment solutions due to some climate change situations that have affected water availability in the country.

Following up on what we have discussed in previous quarters; sales to the government during the first half of the year represented less than 7% of total way below the 41% peak in 2014; in other words 93% of the business today comes from recurrent businesses across

14 different countries where the brand, service, distribution network and innovation are key for success.

I'm proud to inform you that during the second quarter we achieved a successful placement of a Sustainability Bond, the first of its kind in Latin America. The issuance was for a total amount of Ps 2.0 billion pesos with the book oversubscribed 3.76 times and pricing very favorable for the Company. With this Bond, Rotoplas strengthened its financial profile, giving us greater growth capacity for our integrated solutions with maintenance.

As you can see, we are working in the different segments of our business to achieve greater value generation; in line with the reconfiguration of the strategy, we are strengthening our platform of integrated solutions with maintenance that not only give us greater stability in the portfolio, but also benefits with better margins and profitability. We will continue to take advantage of the brand strength and our innovation capabilities to maintain our leadership position in the retail channel, while at the same time taking advantage of the synergies generated by the successful incorporation of recent acquisitions into our portfolio.

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 take you through some financial highlights for the second quarter and first half of 2017 in more detail. As you know, later we will turn the call over to you and we will be happy to respond to any questions or doubts you may have.

We are pleased to continue the trend of positive results observed during the first quarter of the year; our top line recorded a 29.6% increase when compared to last year as a result of higher sales in the retail channel in almost all regions where we participate, showing the company's leadership position in these markets. In addition, the companies we acquired last year have been successfully integrated into the Rotoplas platform, and are performing as expected. Excluding acquisitions, organic revenues were 22.1% up from last year.

Mexico accounted for 65.2% of total sales and continued with strong demand for individual solutions in the retail channel, coupled with higher sales of integrated solutions with maintenance by the incorporation of Sytesa and from the water purifying fountains program that was booked in this quarter. On the other hand, Brazil recorded a growth in sales despite the challenging environment and represented 7.4% of total sales. Finally, the Other Countries region registered a greater demand for individual solutions, as a result of

the effort to increase our participation in these markets despite a strong competition, and accounted for 27.3% of total sales.

It is important to mention that sales in the government channel represented less than 10% of the total consolidated sales during the quarter in line with the Company's strategy to reduce unequal sales that translated in the past into volatility for the P&L.

Sales of the individual solutions increased 17.2% quarter on quarter mainly due to higher demand in the retail channel in Mexico, coupled with sales of water treatment solutions in the Other Countries Division, mainly Argentina and Peru.

Integrated solutions grew 1.9 times when compared to the second quarter of last year as a result of the acquisition of Sytesa and sales from the water purifying program in Mexico, coupled with sales of self-sustainable integrated solutions in Brazil to the government channel.

Gross margin decreased 560 basis points as a result of a higher depreciation component in the integrated solutions with maintenance, in addition to higher raw material costs of individual solutions as a result of a negative FX.

As a result of a disciplined cost and expenses management, operational expenses decreased 430 basis points as a percentage of sales, resulting in a reduction of only 130 basis points in the operating margin, also, net profit margin decreased 230 basis points as a result of a higher tax rate when compared to last year.

In the same line, EBITDA margin increased 20 basis points during the quarter, as a result of higher depreciation related to the acquisition of Sytesa.

It is worth mentioning that EBITDA generation of the quarter was the highest recorded in the Company's history, while Net profit was the highest in the last 15 quarters, as a reflection of the portfolio reconfiguration that we have been implementing over the last two years, aiming to increase the business profitability.

Now, looking at our performance for the first half of the year, sales increased 35.3% when compared to the same quarter of last year, mainly due to higher sales in the retail channel in Mexico and in the Other Countries division of water treatment solutions. Coupled with higher integrated solutions with maintenance. Excluding the Sytesa and Talsar results, organic growth was 24.9%.

Individual solutions recorded an increase of 24.8% and accounted for 87.2% of the total consolidated sales, while integrated solutions grew 3.2 times when compared to the first half of 2016.

Gross profit margin decreased 460 basis points as a consequence of lower contribution from the integrated solutions with maintenance, that could not be offset by the higher sales recorded during the first semester.

Operating margin decreased only 40 basis points as a result of lower expenses as a percentage of sales given the disciplined expenses management all over the Company. In the same line EBITDA margin increased 100 basis points. All the above resulted in a net profit increase of 22.9% for the first half of the year, while earnings per share accrued as of the first semester increased 23% when compared to the same period of last year, proving the business profitability trend during the quarter.

Our cash balance for the first half of the year increased \$531 million pesos since December 2016 mainly due to the debt issuance that Carlos previously mentioned, coupled with a cash distribution in the amount of \$176 million pesos and the acquisition made during the first quarter.

To conclude, the results of the second quarter confirm that the changes made during 2016 and 2016 are proving well; recording the highest level of sales and EBITDA generation of the last 15 quarters is a clear sign that we have been able to overcome the difficulties and challenging environments presented; by focusing on more profitable solutions, while at the same time taking advantage of the brand strength and reputation to support our core business.

As for our 2017 guidance we referred to during our last call, the results of the first half of the year allow us to 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:

Thank you. If you'd like to ask a question, please signal by pressing star, one, on your telephone keypad. If you are using a speaker phone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, please press star, one to ask a question.

We'll go to Pablo Ricalde from Bank of America Merrill Lynch.

Pablo Ricalde:

Hi. Good morning. Thanks for the call. I have two questions on your operations in Mexico, especially on Individual Solutions. The first one is regarding the water fountain program.

Can you share how much revenue or EBITDA was recognized in the quarter from the program and how much is pending? The second one is how are you seeing demand towards second half '17? That's all.

Mario Romero:

Thanks, Pablo. Could you come back again with the second question?

Pablo Ricalde:

Yes. The second question is regarding domestic demand on second half '17. I'm wondering if you have seen a change in trends on these 20 days in July or are you seeing the same trend that you have seen for the first six months of the year?

Mario Romero:

Well for the first question, we booked about 35% of the total water fountains program that we have contracted. That's about 2.5% of our total company's revenue. As mentioned during the call, we have already installed and documented 70% of them, so there's still about 30% more to be booked in the coming months.

To your second question, as you mentioned, first half in Mexico we saw a lot of strong demand in all sectors, not only in Rotoplas. We expect with respect to that growth in the second half that remain flattish to the first half.

Pablo Ricalde:

Perfect. Thank you.

Mario Romero:

Thank you, Pablo.

Operator:

Again, as a reminder, it is star, one, if you'd like to ask a question. We'll go next to Liliana DeLeon of GBM.

Liliana DeLeon:

Hi. Hello, good morning. I don't know if you could give us more color on the recent (inaudible) regions with your 25% in revenues (inaudible) profitability is increasing from 20%. Could you give us more color? Especially (inaudible) in other regions.

Mario Romero:

Hello, Liliana. How are you? As (inaudible) mentioned on our call, you may recall last year we acquired two innovation centers, one which is based in Chile and the other one that is based in Canada. Those innovation centers continue with their research efforts. Those research efforts translate into expenses for the Company while developing new products, so that's the main effect on why other countries, their profitability has been decreased.

Another second effect is (inaudible) all the FX effects into those markets reflects lower gross margin consideration.

Liliana DeLeon:

Okay, thank you very much. What do you expect during the (inaudible) normalization of these expenses?

Mario Romero:

Well, as we mentioned, we—and this is new information for the financial communities. Those innovation centers have a cash burn rate of about 10 million pesos per quarter, so I think this is good to take into consideration that going forward. Those (inaudible) at some point will give us better products and new solutions into a marketplace and translate that into revenue and a growth in sales.

Liliana DeLeon:

Okay, perfect. Thank you.

Operator:

Thank you. We'll go next to Adan Rodriguez of GBM.

Adan Rodriguez:

Hello, Carlos. Hello everybody. Thank you for taking my call. You know, during the quarter we saw that Individual Solutions had a significant profitability increase. Can you give us a little bit further comment on why this happened and if we can expect this to continue in the coming quarters? Thank you.

Carlos Rojas:

Adan, thank you for the question. We have been (inaudible) in Mexico. There's good—the consumption is good in the market. I understand in most of the markets there is good

consumption. I believe this is more (inaudible) in Mexico is doing well, so we don't see a reason why this should not maintain the same way (inaudible).

Mario Romero:

Okay. In addition to that, Carlos (inaudible) and as you know (inaudible) disciplined approach, zero-based budget management and expenses, so the Company—if demand continues robust you'll see operating leverage being (inaudible).

Adan Rodriguez:

Okay, great. Thank you. Another question, if I may. We saw a couple of one-timers in Brazil. Can you give us a little bit more information on that and when do you expect a return to maybe breakeven or even profitability? Thank you.

Mario Romero:

Brazil, it's a very uncertain story. As you may recall, in the very first months everyone was very bullish but now there is again political concern, so we are having a lot of ups and downs from Brazil. We are doing our best effort to bring that division into breakeven. We have all measures in place, cost and expense management, and so there's not much visibility going forward on what to expect from Brazil. As long as revenue grows and we keep tight control, then we'll be closer to reach breakeven. Also, as Carlos mentioned, we are looking at (inaudible) from local payers to offset that (inaudible) in Brazil.

Adan Rodriguez:

Okay, great. Thank you for your comments.

Mario Romero:

Thank you, Adan, for your questions.

Operator:

Thank you. We'll go next to Mason Zheng from Cedar Street Asset Management.

Mason Zheng:

Thank you. I was actually about to ask the same question about Brazil, so I think you have already answered that question. Thank you very much.

Mario Romero:

Thank you, Mason.

Operator:

Thank you. As a reminder, it is star, one, if you'd like to ask a question.

There are no further questions in the queue 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.