Grupo Rotoplas
2Q24 Conference Call

Operator

Good morning and welcome to Grupo Rotoplas' results conference call. Please note that today's call is being recorded and all participants are currently in listen-only mode to prevent background noise. The host will open the floor for questions later.

Today's discussion contains forward-looking statements. These statements are based on the environment as we currently see it and as such there may be certain risk and uncertainty associated with 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.

Please allow me to remind you that the company issued its earnings press release yesterday after market close. It can be found in the investor's section of its website. Also, the presentation for the call and the webcast link are in the investor's section.

Today's call will be hosted by Mr. Carlos Rojas Aboumrad, Chief Executive Officer and Mr. Mario Romero, Chief Financial Officer. I will now turn the call over to the speakers.

Carlos Rojas Aboumrad

Good morning, everyone. Thank you for being with us today to discuss our strategy and the results across our operations. Before we review this quarter's results, I would like to hand the call over to Atlanova, our AI voice and spokesperson on water issues, who will provide an update on the current water situation.

Atlanova, the floor is yours.

Atlanova

Good morning, everyone.

Rotoplas is deeply connected to the environment, especially to the resource that defines the existence on this planet: water. As we analyze current trends, it's evident that the global water crisis continues, with data revealing a path towards critical shortages and scarcity.

The recent heat waves and persistent drought conditions in Mexico have exacerbated the already critical water scarcity. The combination of high temperatures and inadequate rainfall has severely impacted water availability across the country. Currently, 73% of the rainfall evaporates, 21% runs off, and only 6% infiltrates the groundwater.

In Mexico, Rotoplas' operations are crucial, particularly as the country faces acute water scarcity, especially in the northern and central regions. Overexploitation of aquifers and inadequate management practices are key factors affecting both urban and rural communities. As of July 15, the average storage level of the Cutzamala System was 29.1%, a slight increase from previous weeks but still critically low compared to its historical average of 59.9%.

The drought has profoundly impacted agriculture, with 68% of the water in Mexico dedicated to this sector. The reduction in water availability threatens food security and the livelihoods of many communities. For instance, the severe drought conditions have already reduced crop yields by an estimated 30%, affecting farmers' income and increasing food prices.

Additionally, only 17% of the Mexican population has constant access to water. This highlights inefficiencies in water distribution and the urgent need for better infrastructure. The commitment at Rotoplas is to address these challenges through comprehensive water management.

The fight against water scarcity is an urgency humans shouldn't overlook. We are already witnessing the effects of this phenomenon on our operations and communities, as at least 69% of the impact of climate change is expressed through the water cycle. And as we have already shared with you, it is estimated that for every degree Celsius increase in global climate, there is a 20% decrease in the availability of renewable water and change in rainfall patterns.

For example, in the US, as shown in the slide, rainfall has alleviated drought conditions, with improvements observed in 2022, 2023, and 2024. In Peru, as climate change exacerbates temperature variations and increases the frequency and intensity of extreme weather events, people have experienced unusual cold spells this winter.

We have to create resilient water solutions that can withstand the pressures of climate change and population growth.

Thank you for your attention. We look forward to continuing our work together to tackle these challenges and ensure a secure water future for all.

Over to you, Charlie.

Carlos Rojas Aboumrad

Thank you Atlanova. Now after this insightful data let's dive into our quarterly performance.

[Accomplishments + challenges]

This quarter, we have demonstrated our resilience and adaptability amidst a challenging landscape. We have faced unique challenges in each country or region, ranging from climatic issues and increased demand to economic recessions.

In Mexico and Central America, demand for our solutions remains robust, especially during times of water scarcity. Our services platform also performed exceptionally well, with bebbia gaining traction and RSA and rieggo continuing to grow. We are investing in improving our processes to meet demand efficiently, developing robust field services and digital capabilities. This positions us to capture the value our services offer and validates our business strength in water-stress situations. Our participation in the Hot Sale campaign in May with Blue Offers provided additional momentum, boosting sales and reinforcing our commitment to reliable water solutions.

To meet the demand and support growth in this region, we are focusing on:

- Completing the modernization plan for manufacturing technology in storage plants.
- Improving logistics.
- Building the plant in Ixtapaluca to increase production capacity.

In Peru, the climate event that caused severe cold during the winter significantly increased the sales of water heaters. Additionally, we face economic and political instability affecting demand for storage and piping solutions. Our plan is to maintain an efficient fixed cost and expense structure to adjust operations to the size of demand without affecting profitability.

In Brazil, we continue to see positive trends and growth opportunities in developing wastewater treatment plants. We aim to continue business development and secure new contracts by improving our commercial strategy and expanding value offerings, such as consultancy and digital data services.

Moving on to Argentina, the severe economic recession and prolonged devaluation, unprecedented in the last 20 years, have significantly impacted our sales and profitability. Our team remains focused on dealing with strong macroeconomic and political challenges. While it is difficult to provide an accurate forecast, we remain hopeful that Argentina is on a path toward a more favorable economic environment. The inflation rate is decelerating, and the country has achieved a fiscal surplus, which are positive indicators for potential economic development. Our plan includes keeping our team focused on navigating this volatility, remaining alert to potential improvements in top-line growth and profitability, and closely monitoring developments to adjust our strategies, mitigating risks and capitalizing on opportunities.

In the United States, the improvement in the drought situation has impacted demand; however, we continue to focus on returning to profitability. We have identified opportunities to grow our water business and achieve higher margins through a turnaround plan.

Our mission is more important than ever. We must create resilient water solutions that can withstand the pressures of climate change and population growth.

[ESG]

Before moving on to the second section of the presentation with Mario, I would like to highlight some key ESG milestones. Sustainability is central to our operations, and we have made notable progress in this area during the quarter.

In Mexico, we have initiated the supply of 100% renewable electricity for our León manufacturing plant, which is one of our biggest manufacturing facilities. This is a major step towards a more efficient operation, reducing our carbon footprint and supporting our commitment to sustainable practices.

We have also completed the first phase of development for our online environmental indicators platform, leveraging our strategic agreement with Google Cloud to incorporate artificial intelligence solutions into our functional areas, businesses, and internal processes. This platform will enhance our ability to track and improve our levels of efficiency and environmental performance across all operations.

Additionally, we launched the 2024 edition of the "A Fluir" initiative in collaboration with the United Nations Development Program. This program aims to benefit municipalities with high levels of social deprivation and water stress by donating Rotoplas products.

We also implemented the "Rotogotas de Ayuda" campaign in response to the drought in Mexico, encouraging customers and the community to participate in activities that earn points, which Rotoplas then uses to donate water tanks to the most affected states.

Looking ahead, we are committed to maintaining our market leadership by continuously improving our product offerings and expanding our service platforms. Our investments in modernizing manufacturing processes and developing digital capabilities are crucial to meeting the growing demand for our solutions and improving our customer experience. We also recognize the importance of being agile and responsive to market changes.

Thank you for your attention, and I look forward to your questions. Now, I will hand it over to Mario.

[Financial Highlights]

Mario Romero Orozco:

Thank you, Charlie, and good morning to everyone joining us today.

AI Mario will assist me with presenting some of the financial results. Mario, please go ahead.

AI Mario:

[P&L - Financial Highlights]

To begin, I would like to mention that our consolidated results were significantly impacted by Argentina. However, it is important to highlight the strong performance in other regions such as Mexico, Central America, Peru, and Brazil. Excluding Argentina, our growth reached 14% for the quarter and 10% for the semester. Additionally, the EBITDA margin would be 19.7% year-to-date.

Regarding our financial highlights, I'd like to focus on our margins as I will discuss our top-line performance by country and business unit later on.

Starting with the Gross Margin, our pricing strategy and increased sales of Tinaco Plus+ significantly boosted the margin. In the quarter, it reached 47%, an improvement of 140 basis points. For the semester, it was 49%, up 210 basis points. This improvement is also due to lower raw material costs during Q1 and manufacturing efficiencies in Mexico.

However, the growth in expenses, coupled with lower sales, has impacted our operating margins. The main factors include a drop in sales in Argentina, increased logistical costs to meet high demand in Mexico and Central America, and expenses related to the development of digital capabilities. As a result, operating income for the second quarter is 29% down year over year, reaching a margin of 10%. Cumulatively, operating income decreased by 16%, representing a margin of 13%. Consequently, the EBITDA margin decreased to 15.1% for the quarter and 17.8% year-to-date.

Finally, our Net Income saw a substantial increase, reaching Ps. 364 million, a 29-fold rise compared to 2023. Last year, we were impacted by nearly Ps. 500 million due to the valuation effects of currency exchange hedges. This year, we adjusted our accounting practices for hedges to record these effects directly in the cost of goods sold, aligning more closely with operational realities.

For better comparability, we have included a table to analyze the impact of the FX hedging on the gross margin. As shown, from January to June 2024, the margin was affected by 50 basis points. Last year, the impact would have been 870 basis points.

[Regional Performance]

Moving on to regional performance, net sales in Mexico surged by 19% in the quarter and 16% for the semester, driven by robust growth in both the product and service sectors. The product segment, especially storage solutions like water tanks and cisterns, as Charly mentioned, saw record sales, bolstered by water supply disruptions mainly in the central region of the country, as well as by the Hot Sale campaign in May, which we called "Ofertas Azules." The services platform also grew rapidly, with significant growth in bebbia, RSA, and Rieggo. EBITDA margins contracted primarily due to increased operating expenses.

In Argentina, net sales decreased by 37% in Mexican pesos for the quarter but grew by 145% in local currency due to currency devaluation and inflation. Cumulatively, net sales decreased by 34% in Mexican pesos and grew by 176% in Argentine pesos. This impact is due to the economic recession that has affected sales volumes and pricing. Lower sales and dollarized expenses negatively impacted margins.

In the United States, net sales decreased by 11% in Q2 and by 15% cumulatively, primarily due to an easing of the drought situation and heightened competition. The septic tank business refocused to optimize services by geography, currently providing full service only in Texas. Cost containment strategies helped reduce negative EBITDA during the quarter and for the semester. While the EBITDA margin remains negative, it is progressively improving towards breakeven.

Other countries, saw net sales grow by 15% in Q2 and by 3% for the semester, driven by strong performance in Central America and a recovery in Peru during the second quarter. Despite a challenging environment in Peru, sales increased due to higher demand for water heaters during a severe winter. Central America saw growth across all categories, with record storage sales volumes. In Brazil, water treatment and recycling plant projects continue to progress, with significant contract closures. The EBITDA margins decreased due to increased logistics expenses in Central America and construction costs in Brazil.

[Segment Performance]

Regarding the performance of our product and service revenues, services now represent 8% of our total sales.

Within the services segment, we have seen remarkable progress;

- Bebbia has significantly expanded its reach, now serving over 120,000 users, reflecting our successful penetration and growth in the consumer water solutions market.
- Rieggo, taking into account the recent acquisitions, has successfully installed innovative irrigation solutions across more than 55,000 hectares, showcasing our commitment to enhancing agricultural efficiency.
- RSA has increased its scale and reach, while Acuantia Brasil shows promising growth prospects due to ongoing processes with a high likelihood of closing.

Furthermore, our strategic acquisitions have strengthened our market presence, allowing us to create synergies that drive our growth. Additionally, our services sector is experiencing improved EBITDA as it scales up and benefits from additive M&A transactions.

[Cash Position]

Our financial stability is supported by a robust balance sheet with a net debt to EBITDA ratio of 1.8x, well below our policy target of 2.0x.

The cash position includes significant disbursements during the semester, such as $545 million in working capital, $287 million in financial expenses, $243 million in dividend payments, $236 million in capital expenditures, and $178 million in mergers and acquisitions.

Our total debt stands at Ps. 4.3 billion, structured between short-term and long-term liabilities to optimize financial flexibility.

Short-term debt amounts to Ps. 322 million, primarily used for working capital to efficiently manage day-to-day operations. Long-term debt totals Ps. 4 billion, composed of the fixed-rate sustainable bond. The blended cost of debt is 9.05%.

Additionally, we maintain a tight focus on working capital management. Our interest coverage ratio remains healthy, consistently above 8 times, reflecting our strong ability to meet interest obligations.

[Capital Allocation]

During the semester, our capital investments represented 4% of sales, reflecting a significant increase of 24% compared to the same period last year. Notably, 95% of these investments were allocated in Mexico.

We continue to roll out the SMART program to the remaining plants to achieve more efficient and sustainable production of storage solutions like the Tinaco Plus. Additionally, we are investing in the construction of the new plant in Ixtapaluca. Furthermore, we allocated Ps. 53 million to Bebbia and Ps. 22 million to treatment plants.

[Return on Invested Capital (ROIC)]

Our Return on Invested Capital reached 12.7% due to the weak results in Argentina, as well as a higher effective tax rate in Mexico and Central America. However, it's important to note that this figure is still more than 100 basis points above our cost of capital.

[Guidance and Outlook]

Finally, we will update our guidance due to the acute economic recession in Argentina. Our current expectations are:

- Growth between flat and 5%
- An EBITDA margin between 17% and 18%
- Leverage remaining below 2 times
- An estimated ROIC equal or above the cost of capital

I want to emphasize that these estimates will remain valid as long as the situation in Argentina does not deteriorate further and macroeconomic variables in other regions remain stable.

[Closing Remarks]

We appreciate your time and interest. In closing, I want to reiterate our commitment to leveraging our talent and resources to achieve growth and profitability while enhancing the quality of life for many people across the continent.

We can now begin the Q&A session.

Operator: Thank you, Mario. You can submit your questions by pressing the Q&A button. Please include your name and the name of the company you work for. Let's start. We have the first question coming from Carlos Alcaraz, Apalache

Research. He has a couple of questions. I'm going to read the first one, and it's about the Mexican market. What do you consider to be the main driver of revenue growth for the rest of 2024: higher sales volume or higher prices?

Carlos Rojas Aboumrad (CEO): Thank you very much for your question, Carlos and good morning. So, for the remainder of 2024, we expect that it's going to be driven more by volume than by prices. And additional to the volume of existing products, also volume of new products, which continue to perform positively. As you remember, we had a significant increase in new products since we started with the full “Flow” program, and these new products have been performing positively, contributing to growth in the products business in Mexico and Central America.

Mario Romero (CFO): There is a second question from Carlos, right?

Carlos Rojas Aboumrad (CEO): Yes.

Operator: Correct. I'll be reading the second question, and it’s about the services division. At what level of sales do you expect the division to present positive margins?

Carlos Rojas Aboumrad (CEO): Also, very good question. Thank you for your question, Carlos. So I would say that most of the losses that we have in services, or I would say all of them, are due to developing both capabilities and growing the business at this rate. If it was not for the growth rate we're having, if we were to suspend growth initiatives, businesses would already be cash flow positive. Our goal is to sustain high growth rates, so we would expect to have breakeven in services at a higher sales level so that the base is large enough and the margin on the base is large enough to compensate for the expenses for the growth. Mario, I don`t know if you can you share any detail in terms of either by when or by what size of revenue we would expect this to happen?

Mario Romero (CFO): Sure. Thanks, Charlie. And Carlos thanks for joining us this morning. Just complementing what Charlie said, rieggo is very near to be EBITDA positive. We expect that for the end of this year, rieggo and water treatment plants to be EBITDA positive. The main EBITDA dragger is bebbia, which most of the expenses are due to the speed of growth. Precisely yesterday, we were analyzing with the board what, how does the P&L look like if we just stopped growing. And the result is, as of today or for the second quarter of this year, the EBITDA margin for rieggo would be 25%. That gives you kind of a sense of, first, water treatment, which is RSA, and rieggo, will be by year-end EBITDA positive. And second, bebbia, is the one that, because of the growth, is having a negative EBITDA, which together present a negative EBITDA for the services segment. Having said that, we expect to have bebbia in 2026 EBITDA positive. So, putting all the pieces together, we expect that by 2026 to have the services business unit EBITDA positive.

Operator: Thank you. Let's proceed with the next question. So it's: Hey Charlie and Mario, this is Felipe Barragán from BTG. And he has two questions. I'm going to read the first one. What's the strategy moving forward for Argentina? Perhaps this isn't the best timing given the depressed moment the market is going through, but has a potential divestment of the Argentine business been on the table?

Carlos Rojas Aboumrad (CEO): Thank you very much for your question, Felipe. Thanks for joining. So I think we have been very disciplined in analyzing each of the businesses individually. We have done this since well, in my opinion, since 2009. We have had divestments in the Company: we divested from a manufacturing business in the US, we divested from a manufacturing business in Brazil. And so these conversations do take place in Rotoplas, but like you mentioned, it is not the best moment to consider this very actively because of the depressed situation of Argentina, but it wouldn't be specific to Argentina. We would consistently consider divestment opportunities in Rotoplas. Argentina I think has tremendous uncertainty, and we would really like to see what happens in the country in the next one or two quarters, where I think we will have much more clarity of what's going to happen in that market. I have traveled to Argentina recently, I have been very close to the country, and I have seen a very different possibility for Argentina. I would be keen to see whether this really materializes in a different way, where a very long-term trend for Argentina might change. Obviously, then, consider more seriously what is the best path forward for Rotoplas in terms of our participation in Argentina. Mario, anything else that you care to share?

Mario Romero (CFO): Sure. First, thank you for joining us this morning, Felipe. As you mentioned, this moment is not the best to make any calls. I think we need to remember that Argentina goes through these big cycles every two decades, before, there were smaller cycles, which is what we were expecting. So I think the long-term strategy for Argentina hasn't changed. If you remember for the last four years, Argentina has been performing very well. Not because this first half was very bad, it's something that we need to rush and make a decision. And also as Charlie mentioned, we're always analyzing where to invest and also where to divest. As we have shown in the past, when we sold our business in Brazil, then we sold part of our business in the US. We are actively looking at business performance and making decisions accordingly.

Operator: Perfect. So, the second question: how has the programmatic M&A pipeline come along? When can we expect more transactions for this program?

Carlos Rojas Aboumrad (CEO): Mario? Would you like to?

Mario Romero (CFO): Sure. Well, the programmatic M&A, as explained a couple of meetings ago, it's the same. We are focusing in Mexico with a light touch in the US and Brazil, mainly in the water treatment and now the bebbia business. As you know, before, the rieggo business was also included but we've done, we did, so that's where we're standing. We are very active looking at different alternatives where to allocate those investments to accelerate the growth of our current portfolio.

Operator: Perfect. Let's move forward with the next question and it's from Regina Carrillo from GBM. Good morning, Charlie and Mario. She also has two questions. I'm going to read them separately because they are about two different topics. I'll read the first one: regarding the update in guidance, can you give us more color on what trends to expect by region for the second half of the year?

Carlos Rojas Aboumrad (CEO): Mario, would you like to comment first?

Mario Romero (CFO): Sure. Let's go from north to south. I think it's the best way to explain what are we looking. In the second half of the year we expect stronger performance from the US, better, stronger sales and better EBITDA margins. Second, in Mexico and Central America, we expect a very similar performance in revenue but more efficiency in SG&A. So we are expecting to reduce expenses in the second half in Mexico and Central America, mainly driven by a slowdown on the IT initiatives cause most of the deployments were done in the first half. Peru, we believe, will be pretty much the same as in the first half. It's more tied to the macroeconomic environment, where, as you can see from different reports, Peru economic perspective doesn't seem to change a lot. Brazil is a small portion of the business, good momentum, but it is not going to move the needle in terms of financial performance. And finally, Argentina is the big question for everyone. In the past couple of days, through our different board and committee meetings, we have had big discussions around Argentina for the second half. As you know we have some Argentinean board members, they mentioned that there are still a lot of unknown variables. They expect that the second half of the year will be much better than the first half, but again the year is still out there. We hope that the recovery will start happening in the second half. We've seen, you probably have also noticed, some encouraging news regarding sequential economic growth in Argentina, so we are very focused on seeing what's going to happen in Argentina. So from all what we have said I think the big question mark is around Argentina, the other markets will be pretty much stable and performing better than in the first half. Charly, would you like to add anything?

Carlos Rojas Aboumrad (CEO): Just to reiterate, we will have a strong focus on managing expenses, that is something that is under our control. In Argentina, what we will be focusing most on is having the agility to respond to whatever the outcome is. So, discipline in expenses and agility. Thank you very much for your question.

Operator: Thank you, guys. Regina's second question is about CapEx, and then we also have two other questions from different people, Andrea and Raul, that are also about CapEx and the Ixtapaluca plant. So I think we can wrap up those three questions together. And the question is: what is the progress on the technological renewal of your Mexico plants, and how much CapEx should we expect related to these in the next quarters? Also, Raul is asking about the CapEx in the next two years, and Andrea in the Ixtapaluca plant.

Carlos Rojas Aboumrad (CEO): Thank you very much for your questions and for joining, Raul, Andrea, and Regina. One of the major investments we have been having has been modernizing our water tank manufacturing processes. We have completed the vast majority of this project, I would say we are close to 90%. Ixtapaluca is a manufacturing plant to serve the central part of the country, particularly Mexico City, being the biggest market. We had been serving this market through the first manufacturing plant Rotoplas ever had, this was close to Xochimilco and it used to be in a well-suited place to do manufacturing. The city grew so much in the last four decades that this manufacturing plant ended up in the middle of a residential area. So, we have developed a new manufacturing plant in Ixtapaluca, which is also very well located to serve the Mexico City market. We have now started manufacturing in this facility since the second half of May. This was the last major manufacturing facility to be modernized in the water tank manufacturing process, so this is why I say that we are close to finishing the investments from this modernization project. In the next couple of quarters, that CapEx will be coming down for the manufacturing of our products, and CapEx will be more focus on continuing to develop digital capabilities that can be capitalized and waste water treatment plants or water treatment plants in general. Mario, any details you can provide in terms of CapEx looking forward?

Mario Romero (CFO): Just to give you some color, I think what we are going to be seeing is a trend of CapEx reduction in the second half because we are almost done with all the Tinaco Plus initiative, which was a large CapEx initiative that took approximately two years to complete. Going forward, you will only see more maintenance CapEx on the product side and some specific CapEx in water treatment as we invest in new plants. And bebbia, as you know, a year ago we started to capitalize the equipment, so the CapEx you will be seeing is mostly growth in the services part, water treatment plants and bebbia, and maintenance CapEx in the product side.

Operator: Thank you guys. We have another question from Rodrigo Salazar, AM Advisors. Actually, he has three questions. I'll start with the first one. Could you expand on the sales and expenses in the services segment and an approximate of how much each business is contributing? Also, explain how much of the growth we saw was inorganic.

Carlos Rojas Aboumrad (CEO): Mario, would you care to share whatever color we can provide?

Mario Romero (CFO): Sure. Good morning, Rodrigo. Thanks for joining us this morning. I think the best way to see the business is first how the three businesses in the services segment contribute in revenue. Give or take, RSA and bebbia are about 35-37% of revenue, and the remainder coming from Rieggo.

Carlos Rojas Aboumrad (CEO): 35% each

Mario Romero (CFO): 35% bebbia, 35% RSA and the remainder, which is a little bit low, below 30% comes from Rieggo. And then, in terms of the growth, from the 63% you’re seeing in the growth, 45 points come from organic growth, 18 come from inorganic growth. The acquisitions we did in the first half of the year, which is the treatment plant in Puebla and the IrriVan business, those two account for about 25% of the total growth. Again, 63% is the growth: 45% organic, 18% inorganic. And then in terms of expenses, the biggest expense driver in the services segment is bebbia, and it's driven by growth. I was mentioning early on, when Carlos from Apalache asked us about when to breakeven, bebbia, as you know, we do a lot of commercial and marketing efforts to acquire new customers and that is where the expenses growth is coming. If we were to stop that and stop growth, everything would be EBITDA positive. But I think right now, the market is so attractive on the 3 units for Rotoplas that we have a keen focus on growth initiatives. I don't know if Charlie if you want to complement.

Carlos Rojas Aboumrad (CEO): No, thank you Mario.

Operator: Okay, so we can move forward to the second question. Can you provide insights into your working capital management for the upcoming quarters? Are there expected recoveries or challenges? Additionally, we observed higher interest payments this quarter. Could you elaborate on the reasons behind this increase?

Carlos Rojas Aboumrad (CEO): You could start, Mario?

Mario Romero (CFO): Yeah. Let's start with the interest payment part. The only additional interest that we paid is from the revolving credit, the short-term that we mentioned in the press release and early on when we were presenting the results. That's the only additional interest. The rest is a fixed rate from the bond, which is a fixed rate of 8.65%. The revolver credit is the one that is paying additional interest, but that's it. Probably, Mariana, we can provide Rodrigo with just a breakdown of the interest payments from the revolver facility, which are small. The main part comes from the fixed rate, which is what we've been doing in the past few years. In terms of working capital management, and again, it's all tied to what to expect with Argentina, because what happened in the first half or the second quarter is, on one side, you have Mexico and Central America performing very well. You have the products division growing very fast, you have the services division growing very fast, so those are working capital eaters, meaning they need working capital. On the other hand, the second-largest business, which is Argentina, because of the recession, working capital has been slower. Inventories have built up, it's not that we have to keep buying more stuff, is just that it takes time to reduce inventories. When you put all that together, you see a double effect on working capital increase. As mentioned early on, we believe performance in Mexico and Central America will keep at the same level. And again, if Argentina improves, then the working capital in Argentina, which is the main drag, will improve, and overall, the company's working capital will be better off. If Argentina deteriorates further or does not improve, then you will be seeing pretty much the same level of working capital going forward.

Operator: Perfect. And the last question: could you expand in the margins in Argentina? Was there something special in the quarter, or with this current situation and the current level of sales, can we expect margins to remain this low?

Carlos Rojas Aboumrad (CEO): I think margins will reflect how we operate, depending on the changes in volume in sales. This is where we have mentioned that there will be high uncertainty going forward, Rodrigo, I think we will have more clarity for the next quarter, but for now, we do expect margins to be low as we are considering still very challenging economic growth situation in Argentina. We do see some growth starting to happen, but it is still unclear how much that growth will be. Now, in terms of margins also, as mentioned, we will be focusing very much on controlling expenses, and I think we can improve margins slightly through our practices and through our control of expenses. I don't know Mario, if there is anything you'd like to add?

Mario Romero (CFO): I think just to round up what Charlie said, margin expansion or contraction in Argentina is all tied to revenue sales. We are making great efforts to keep what we control under check, which is controlling expenses. We are very keen on what to do and how we do it, and as we mentioned early on, it's a temporary thing, and we don't need to rush on making decisions. We keep a focus on maintaining or gaining market shares, keeping the team motivated, and helping them navigate this complex situation that the whole country is facing. Actually, as you know, we have regional board meetings, and we have a specific board advisory for Argentina, and they were telling us that it is really remarkable that given the situation, we are posting positive EBITDA. It's not the best news for investors, obviously, but the team, the local team in Argentina and the corporate team are making tremendous efforts to keep this situation the best we can.

Operator: Thank you, guys. So, moving on to the next question. Andrea Montiel from Miranda Partners and we also have a question from Martín that is related to services. Both asking about what's coming next. I'm going to read Andrea's question: how do you anticipate sustaining this growth trajectory in services sales, given the strong performance of bebbia, RSA, and Acuantia Brazil?

Carlos Rojas Aboumrad (CEO): Hello, Andrea. Thank you for the question, and thank you for the question as well, Martín. So, yes, we've been having very strong growth in services. The growth happens as a consequence of two things, or three things. The first, obviously, is that there's a need for these solutions, and what we're offering in services is quite novel. It's a way where customers resolve their water issues with a better experience and with a better result. So, I think the design of these solutions, of these services, has been very well done, and customers are looking for these solutions. But to serve a large scale of customers with these solutions, which happen to be decentralized solutions, we need to develop capabilities, that have taken time. As we have been developing these capabilities, which is the second one, then our revenues have grown. As we continue to deliver on the capabilities we've been building, revenues will continue to grow because the size of the opportunity in this business is very large. Lastly, it's about customers learning about these services that we provide. Rotoplas has a very well-known brand, not necessarily for the services, it's mainly for products, but we do leverage that brand to communicate that we offer these novel solutions through services. As we continue to make progress in customers learning about this new approach that Rotoplas offers, then revenues will continue to grow. We do see sustainability in the growth because of the size of the opportunity, and because of the attractiveness of these services, and lastly because of the development of our capabilities to systematically serve these customers, through these capabilities, even on a much larger scale. What I mean larger scale it means being repeated in more times not bigger solutions, but more customers. Mario, anything else?

Mario Romero (CFO): No. I think you just... I'd just probably add up that, over the past years, we've been investing through expenses on different initiatives to facilitate this speed of growth. That the company setup is in good shape, technology as we've been pointing out in the past calls, we have put together all that so we can sustain that speed of growth going forward. Let's say that we have put the railroads for three promising businesses that should eventually move the needle going forward.

Carlos Rojas Aboumrad (CEO): And just very quickly, we have only five minutes left and a couple of questions left. But, in these services, we had to develop capabilities that were very new for Rotoplas because it was such a different business from what we were used to. So, a lot of investment went into us learning how to participate in these solutions through this service approach. I think we have learned very much, and we are benefiting from those learnings today in a way that delivers very high growth. Thank you again for your question.

Operator: We have another question. It's from Miguel Medina. How much of the plant modernization process has already been captured in the P&L? Should we expect more gross margin gains from efficiencies in the product division? Thank you.

Carlos Rojas Aboumrad (CEO): So, in terms of reduction of costs because of the modernization, I would say that most has already been captured, as we mentioned, most of the transformation has already been executed. I don't know, Mario, if there's a particular number.

Mario Romero (CFO): Thanks, Miguel, for joining this call. I think you are going to be seeing in 2025 the full effect of these new manufacturing and technological shifts that the company started two years ago. For 2024, what we expect is that 60% of the Tinacos will be produced with the new technology, 40% will still use the previous technology. So, having said that, I think you will still see some improve in gross margin in the coming months.

Operator: Thank you. And the last question is from Andrea Montiel: can you elaborate on the specific projects funded by CapEx investments and their expected impact on future growth?

Carlos Rojas Aboumrad (CEO): Maybe you can provide the precise data, Mario, but we have invested few hundred million pesos in strategic CapEx. All of our initiatives, every time we execute CapEx, it comes through a formal initiative that goes through the process of "Flow", where we have a format where we look to have clarity and validation that gives us an expected IRR, and an expected IRR for strategic CapEx, is over 25%. Maybe you can be a little more precise Mario.

Mario Romero (CFO): Just connecting with what you said. If you see CapEx, let's put it this way: organic and inorganic, let's include everything there. The company has been focused on first modernizing all the technology to manufacture better water tanks, which has been an important deployment of CapEx. The second part has been accelerating water treatment plants by building new assets and acquiring new assets, such as the water treatment plant in Puebla. The third one has been to put add-ons to Rieggo, to make it a more robust business and take advantage of the opportunities we are seeing in water management in the agricultural business in Mexico. The fourth one is bebbia, bebbia with the speed of growth and the way we have changed the accounting for equipments. Those are the four components that probably make up about 95% of the CapEx. The other 5% is mostly maintenance CapEx, just to keep up our manufacturing plants. But those four pillars are the ones that the CapEx has been deployed around. Connecting with the previous question, what you're going to be seeing going forward is the technology upgrade for the water tanks, that is going to start slowing down, and we're going to be left of with two: which is water treatment plants on one side and bebbia on the other side, plus maintenance CapEx, which you have to do it every single year.

Operator: So this concludes our Q&A session for today. Have a great day, and we look forward to our next meeting. Is there something you would like to add, Mario or Charlie?

Carlos Rojas Aboumrad (CEO): Just thank everyone for your participation and your time.

Mario Romero (CFO): Thank you for joining us this morning. If you have any further questions, please reach out to me, or Charlie, or the team. We're happy to answer back to you.

Carlos Rojas Aboumrad (CEO): Bye.

Mario Romero (CFO): Have a great day. Bye-bye.