

Grupo Rotoplas

3Q18 Conference Call

Corporate Participants:

Carlos Rojas, *Chairman, Chief Executive Officer*

Mario Romero, *Chief Financial Officer*

Operator:

Good morning and welcome to Grupo Rotoplas Third Quarter 2018 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, Rotoplas' Chairman and Chief Executive Officer, and Mr. Mario Romero, Chief Financial Officer.

I will now turn the call over to Mr. Carlos Rojas.

Carlos Rojas Mota Velasco:

Thank you, and thank you all for joining us.

As you know, yesterday we reported that we registered double-digit growth in sales and EBITDA, year-over-year, in both in the third quarter and the first nine months of the year. And the main drivers of this growth were the performance of our operations in the United States, the integration of the results from our recent acquisition in Argentina “IPS”, and the sales increase of water-as-a-service in Mexico. All in all, I believe that this is evidence of our ability to successfully integrate our acquisitions and leverage the synergies they provide. And just as importantly, it highlights the potential of our integrated solutions businesses, which continue to gain a more prominent role in our operations. In fact, after a very successful trial run, we have begun the expansion of our “Drinking Water” platform, which comprises residential and commercial purification services to several Mexican cities.

We also registered significant growth in Central America and Peru, overcoming a challenging first semester for our operations in those countries and further consolidating our position there. And even though the depreciation of the Argentinean Peso had a significant impact on our overall results, it is worth noting that our operations in Argentina grew faster than the industry average and gained market share, enabling us to take advantage of the market opportunities that are arising in the country. Moreover, the integration of IPS, a company with over 70 years of history which has a healthy balance sheet and a very competitive export platform that will greatly aid us in consolidating our presence in South America as a whole. We will continue to execute our strategy for the region, taking a long-term view as we always have, and I feel confident that, as the volatility recedes, our operations in Argentina will make an even greater contribution to our company’s growth.

Moving forward, we will continue to emphasize innovation and sustainability, and, in the same vein, we will continue to seek new opportunities for growth, both organically and through acquisitions. A few days ago, we reopened the second issuance of the Sustainability Bond, which was oversubscribed 3.8 times and netted 1 billion pesos. This funds will be earmarked to the water-as-a-service businesses in Mexico. And we continue to be included in the DJSI MILA Pacific Alliance Sustainability Index, which attests to our superior performance in this area. Finally, it is worth noting that government sales were below 3.0%, exceeding our goal in this respect.

Thank you for listening. I would now like to turn over the call to Mario, who will guide you through the quarterly results. I look forward to your questions.

Mario Romero Orozco:

Thank you, Carlos. Good morning. Thank you for joining us. I will now go over some of the financial highlights of the third quarter.

As Carlos mentioned, sales grew 27% year-over-year this quarter, with a major contribution from our recent acquisitions and a greater demand for our integrated solutions in Mexico, and EBITDA increased by 11% over the same period. It should be noted that the depreciation of the Argentinean Peso had a negative impact of 8% in Rotoplas total sales.

Furthermore, the weakness of some of the region's currencies against the US Dollar and the price of commodities increased the cost of raw materials, which had a negative effect on some of our margins but was partially compensated by a better price mix and cost efficiencies. This FX volatility in Argentina and higher net interest payments derived from a positive net debt position, both had a significant impact on net income.

As for our geographic breakdown, sales in Mexico grew 4% during the third quarter, accounting for 54% of our total sales, down from 65% in the previous quarter. The other countries category, which includes our operations in the United States, Brazil, Peru and Central America grew 65% year-over-year. And, as Carlos already mentioned, our operations in Argentina grew 39% organically in local currency, even though this growth was offset by the 41% depreciation of the Argentinean Peso. Nevertheless, it is worth noting that we have not only maintained but expanded our market share across all our market segments, evidencing the strength of our brand and service.

Regarding our product mix, sales of individual solutions in the second quarter accounted for 89.9% of total sales and grew 27.7% year-over-year, boosted by the integration of IPS and the growth of our operations in the United States. For their part, integrated solutions accounted for 10.1% of total sales and registered a 18.5% increase year-over-year, which is mostly attributable to sales of waste-water treatment plants in Mexico. There was a reduction in the EBITDA of integrated solutions mainly due to the expenses associated with the ramp-up of the water-as-a-service platform in Mexico which is burning in excess of \$8million pesos per quarter as more customers are being acquired.

The fact that our acquisitions are nicely complementing the company's product and service portfolio combined with the organic growth of our businesses

particularly that of our water-as-service in Mexico, attest to the strength of our current growth strategy and reaffirms our positive long-term outlook of a sustained double digit growth rate.

Going forward, we feel confident that for 2018 we will achieve organic double-digit growth for Sales and EBITDA and we will maintain a strong balance sheet with a positive debt outlook for future growth.

Finally, I would like to make a brief aside to mention that the \$111 million pesos increase in depreciation and amortization component for the first nine months corresponds to \$48 million pesos for the company's growth, \$33 million pesos for one-time M&A related expenses for the e-commerce platform in the United States and the water flow business in Argentina and \$29 million pesos for one-time accelerated depreciation due to solar panels installation in Mexico and machinery divestiture in Brazil. I hope this clarifies some doubts which may have been unclear in our past conference call.

I would like to have the opportunity to answer any questions you may have. We will begin with the participants in the conference call, followed by our website users. Please proceed.

Operator:

Thank you. If you would like to ask a question, please press star, followed by the digit one. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Once again, star, one to ask a question, and we'll pause for just a moment.

Our first question, we'll hear from Eric Neguelouart with Bank of America Merrill Lynch.

Eric Neguelouart:

Hi, thank you for the call. I just have one question. I would like to see if you can explain to us further the costs related to the drinking water platforms, please, in Mexico.

Mario Romero:

Hi Eric, and thanks for your question. As some of you are aware, last year Rotoplas decided to launch an (inaudible) service in Mexico of promoting people to hire the service of purifying water at the point of use. We started with a pilot project last year. It became very successful, and this year we decided to ramp up and scale it to other cities. This business is breakeven at the gross margin level. As of the third quarter, we have in excess of 7,200 clients, and (inaudible)

all the (inaudible) marketing efforts and acquiring new business is creating additional expenses in excess of 8 million pesos per quarter. We believe that it will continue for at least the next two quarters (inaudible) achieving 15,000 clients. That is where breakeven at the EBITDA level comes.

Eric Neguelouart:

Okay, thank you very much.

Operator:

As a reminder, it's star, one if you would like to ask a question.

We have no further questions from the phone.

Mariana Fernandez:

We have a question from Liliana Deleon from GBM. Could you share with us comments regarding strategies to mitigate the FX effect in Argentina?

Carlos Rojas:

Hello Liliana, thank you for your question. First of all, I have to tell you I spent with my team a few days last week in Argentina to get acquainted with what is happening in the economy, and what we understand is that we will continue certain (phon) during this year with economy but it should start getting much better in the next year, especially second and third quarter. During this period (inaudible), we are taking care of those synergies we have found with our group in this company that we found a strong Management team, and we find that we can improve significantly the productivity by the (inaudible) in Mexico, so it's our belief that this is a result that we are going to achieve in the very short term. Second, we found a strong push on their side, the commercial side, that we will use to create opportunity on the cross selling with our other products, like water heaters and water tanks, so we believe (inaudible) will be showing in the short term.

At the same time, we have been improving our export (inaudible) exchange rate so we have the company running at full capacity. We're confident that this acquisition will be very good for the group in the short while.

Do you want to add something?

Mario Romero:

Carlos has clearly explained, just I think it's important to mention that 20% of the volume being produced in Argentina is now being exported to Africa, and that will compensate the downturn in the local market for the fourth quarter

and first quarter that really are going to be challenging in terms of the economic environment.

Carlos Rojas:

We found that the macroeconomics in Argentina, they are expecting in their agriculture (inaudible) some records in this crop over this next year. Also, we are expecting a reactivation in the construction where people want to invest their savings in construction, and also they see a possibility the economy (inaudible) in Brazil if the nation is in favor of Bolsonaro again on the 28th of October, so these three situations should bring a very fast recovery for Argentina in the next year. Thank you.

Mariana Fernandez:

Thank you. We have another question from Liliana Deleon from GBM. Do you have any update for the 2019 guidance in terms of sales and EBITDA growth?

Mario Romero:

Liliana, is this for 2019 or 2018? Yes, the relevant answer is we're not going to give in this call guidance for 2019, but I can confirm, which I did during the call, that we're going to post double digit growth organically. We believe that sales are going to be growing organically around 10% for the whole year and EBITDA around 20% for the whole year.

Operator:

We do have a couple more phone questions. Would you like to take those?

Mariana Fernandez:

Sure

Operator:

We'll hear from Damien Fraser with Miranda Investor Relations.

Damien Fraser:

Hi Carlos and Mario. I think you may have just partially answered this question, but the question I had was whether you believe that Rotoplas has sufficient pricing power in Mexico and Argentina to offset the increase in raw material costs and recover the EBITDA margin that you had in the past, or whether we should expect the existing margins to be the new normal.

Mario Romero:

Hi Damien, and thanks for joining the call. As pricing power in Mexico, yes we do, and we have already increased prices. (Inaudible) of three months to see it fully released into the market, so you will see that going through the fourth quarter. As for Argentina in the inflationary environment, the three business segments that we have, all of them are market leaders and we are increasing our prices faster than inflation. We are (inaudible) on Mexico all the raw material increases and in Argentina the FX increases for us, all the local cost increases which are being adjusted to the rapid inflation. So, in a nutshell, the answer is yes, and we are already working on that to deliver the results in the fourth quarter.

Damien Fraser:

Thank you very much.

Operator:

We'll move on to Eric Neguelouart with Bank of America Merrill Lynch. Eric, your line is open.

Eric Neguelouart:

Sorry, I had the mute on. A follow-up question. You were mentioning a 10% growth in top line, a 20% growth in EBITDA. That would imply margin, a considerable margin expansion. Would that come from a decrease in costs in PET costs, or would that come from just price increases? I would like to understand.

Mario Romero:

Well, on the first question, I was answering that we will have a better reflect of the price increases in the fourth quarter. That will imply better margins on that side, and also on the raw material side, we are forecasting that there are going to be better prices than the previous three quarters, so both effects will help our margins going through the fourth quarter.

Eric Neguelouart:

Okay, thank you.

Mariana Fernandez:

We have another question from Matthew Pigott from Jupiter Asset Management. Can we please have an update on the water treatment business? How have the trials gone, and when do you expect to recognize revenues from this business?

Mario Romero:

Hi Matthew, and thanks for joining the call. As of the third quarter, we have moved from 510 water treatment and recycling plants to 567 water treatment and recycling plants. The target by year end is to close on 600. That represents a 17% growth rate year-over-year. (Inaudible) as we finished construction on the water treatment and recycling plants, revenue is being recognized. We have 100 treatment plants (inaudible) of them have already been constructed, some of them are in the process, and some of them are starting, so we will start to see some revenue recognition in the fourth quarter and the full effect going into 2019. That's for water treatment and recycling.

For the water as a service purification at the residential level, we closed, as mentioned, with 7,200 purification points, and we are posting a 22% increase sequentially quarter over quarter. We are starting around 650 purification points of use (inaudible) and that's picking up as we acquire more customers and we improve our operational capabilities.

Finally as for water fountains for schools, we are finishing up the installation of the (inaudible) 250 schools. Some of that revenue has already been recognized, some is still pending to be recognized, so that business all in all, there is some units being installed and revenue recognition will come over the next quarters.

Mariana Fernandez:

(Inaudible) do we have another question on the phones?

Operator:

There are no further questions.

Mariana Fernandez:

Okay, well thank you very much for your time and your interest. We hope you will join us again next quarter. Until then, we'll be sure to provide you with important updates.

Operator:

That will conclude today's call. We thank you for your participation.