

Grupo Rotoplas

3Q22 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.

- **[DISCLAIMER]**

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.

- **[PRESENTERS]**

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 Mr. Carlos Rojas.

Carlos Rojas Aboumrad:

Good morning, everybody. Thank you for joining our call today. We are always glad to have the opportunity to talk to you about our recent efforts and of course, our results.

- **[RECORD SALES & EBITDA]**

We are pleased to share with you that our revenue and EBITDA reached a new historical record for our company for the second quarter in a row. And just as importantly, we have achieved these records while continuing to strengthen our core, traditional business and pursuing new avenues for growth. That is to say, we continue to leverage our current strengths with innovation and agility just as we continue to lay the foundations for our company's future.

Before we get into that, however, I would like to take a step back and talk about the broader, dire concerns that our societies are facing and particularly the issue of water scarcity. We are all very familiar, no doubt, with the current uncertainty brought about by inflation, interest rates and the complex economic growth outlook across the United States, Europe and our Latin American markets. It is crucial, however, that in dealing with these immediate concerns, we don't lose sight of the trends that have been shaping and will continue to shape the daily lives of millions of people in our hemisphere.

- **[NEWS - HEATMAP]**

The effects of climate change continue unabated. Heat waves, wildfires hurricanes and droughts become harsher and more unpredictable. And the demand for clean and good quality water constantly exceeds the supply in many regions. As we look at the heat maps of water stress across the world, we can see how some regions where we operate are increasingly at risk of running out of water and, crucially, there are areas in which this is already happening. In this context, a commitment to bringing about smarter, more efficient water solutions, as well as a broader observance

of ESG principles, makes not only good business sense at this moment, it is also indispensable for the well-being of our societies of today and tomorrow.

At Rotoplas we strive to respond agilely to the opportunities that arise in the short-term as well as to address the longer-term needs of our societies. And we are able to do so by leveraging our market leadership and tradition of innovation with the agility brought about by our transformational program Flow. We are creating value for our investors while continuing to ensure that we remain at the forefront of a key industry.

- [BULLETS MIXTOS /ROIC]

How are we doing it? For starters, we continue to invest on new business opportunities that strengthen our presence in key markets and contribute to our ability to bring smarter water solutions to our customers, enabling them to make the best use of the water they have available. This is, as we have talked about in previous calls, our investment in building the Rotoplas of the future: taking advantage of the investment opportunities that arise and that we firmly believe will be strong growth and technological innovation drivers in the near future.

And as we continue to build our company's future, we also remain firmly focused on strengthening our core businesses. The strength of our brand and the strong relationships we have built with our suppliers, distributors and costumers over the years are amongst our key assets. The positioning of Rotoplas and the networks we have created, as well as our financial position enable us to bring new and traditional solutions to the market with greater efficiency and impact, as well as to respond to changing market conditions agilely and profitably. In fact, as we have discussed in previous calls, we have succeeded in maintaining a steady supply of raw materials in the midst of major supply-chain disruptions, to continue investing in the modernization of our production processes and to implement an agile pricing strategy. As a result, we were not only able to meet the demand for our solutions, but we also enhanced our market

leadership, and we took firm steps to reducing our own environmental footprint.

The water industry has proven to be resilient in downturn economic cycles, as it addresses the key and constantly evolving need for water. And as Mario will discuss in further detail in a moment, our core business, which we consider to be solutions to adapt to climate change, continues to demonstrate its strength. As I mentioned, this is the second quarter in a row in which we have achieved a historical record for both revenues and EBITDA, driven by the demand of our solutions and our pricing strategies, as well as our relentless focus on profitability and on creating value for our investors. We have achieved a ROIC 230 bp above the cost of capital, and most importantly we observe a change in trend.

On the other hand, we see our new value proposals or developing business, which are solutions to mitigate climate change and are aligned to more sustainable consumption patterns. These businesses are still in an investment phase but have a strong earnings and growth potential.

As we move forward, we will continue to monitor closely both the macroeconomic trends and the evolution of each of our markets, making sure that we prioritize the initiatives that have the most potential in terms of value-creation and impact. And with the agility brought about by Flow, we will make any adjustment necessary to ensure that our most important growth and value-creation drivers remain on course, while maintaining our steadfast commitment to the best ESG principles and practices.

- [CSA + HSBC]

I'm proud to share that we have increased our score in the S&P Ratings Corporate Sustainability Assessment, showing our efforts to maintain Rotoplas as best-in-class sustainable company. Also, Rotoplas was recognized by HSBC as winner in sustainable innovation in the Governance dimension among its category, companies with total revenues above +5 billion Mexican pesos.

Thank you very much for your time. I will now turn the call to Mario and I look forward to your questions.

Mario Romero Orozco:

Thank you, Charlie. And thank you all for joining us today.

- **[P&L]**

Our results this quarter highlight the strength of our core business and the agility with which we can now respond to challenging market conditions to pursue both profitability and long-term sustainable growth. We have maintained a strict expense and capital allocation discipline as well as a continually adjusting pricing strategy, all of which has enabled us to leverage our market leadership and financial strength to continue developing our new businesses and modernize our traditional ones, continuously improving our margins to ensure our profitability.

- **[Financial Highlights]**

Quarterly sales increased 23% year-to-year, totaling \$3,543 million pesos, and our EBITDA reached 582 million pesos. Both quarterly sales and EBITDA represent a new historical record for our company, surpassing the previous record established in the last quarter. Sales have grown 19% in the first nine months of the year, 400 basis points above guidance.

Quarterly sales of products grew 25% year-to-year and 21% in the first nine months. We registered growth across all three categories—storage, water flow and improvement—both as a result of our pricing strategy and an increase in the sales volume of storage solutions in key markets. The continuing strength of product sales has compensated the performance of services, which have had a slow recovery after the pandemic.

Our pricing and expense control strategies have also enabled us to continue improving our margins, both sequentially and year-over-year. In fact, our

quarterly gross margin expanded almost 800 basis points year-over-year and more than 400 basis points for the first nine months.

Our quarterly SG&A increased slightly more than our sales, as the expenses associated with the development of Acuantia in the United States, Bebbia in Mexico and the water treatment and recycling plants business in Brazil exceeded their marginal contribution to sales. These investments in new businesses aimed to mitigating climate risks impacted our EBITDA by \$79 million pesos during the quarter and \$232 million in a cumulative basis.

Nevertheless, our quarterly operating result grew more than 2.5 times, whereas the quarterly EBITDA margin increased 370 basis points. That is to say, we carry on growing and improving our profitability even as we continue to invest in new growth avenues, and we are on track to meet our guidance for the year. Furthermore, as some of you may recall, as of this year we are not adjusting EBITDA to account for the expenses associated with Flow.

In the next slide we can observe the two sides of the company. On one hand the traditional businesses and in the other hand the new businesses.

- **[Value and growth]**

The market leadership position of our brands and solutions, which was built over many decades, provides a solid technical and financial platform for both continued innovation and the pursuit of new growth opportunities.

The cash flow generation and profitability of the value side of the business has allowed us to pay dividends and invest in new businesses.

Now, moving forward to our geographic breakdown.

- **[Sales per Country | Mexico, Argentina & US]**

Quarterly sales in Mexico grew 16% and 12% year-to-date, as we registered a strong demand for our storage and water flow solutions, driven by the droughts in Northern Mexico.

bebbia's user base continues to grow at an accelerated pace. Despite the strong growth in bebbia it does not compensate the lag in the demand for water treatment plants. Nevertheless, the increase in demand for products and our pricing strategy still led to strong overall growth and a continuing improvement of our margins: the quarterly EBITDA margin reached 20% and 19% in a cumulative basis.

In Argentina, quarterly sales grew 63% and 54% in the first nine months of the year. This record level of growth, exceeding inflation, was driven by our price and commercial strategies, as we successfully leveraged our leadership position in the region. Additionally, the operational leverage allowed us to increase profitability and close with a cumulative EBITDA margin of 18%.

Sales in the United States grew 2% in the quarter and 10% year-to-date. driven by sales related to government relief programs for droughts, especially in California, as well as the development of the septic business.

Pre-operating expenses from the septic business and technological expenses for the expansion of the e-commerce platform negatively impacted the EBITDA, resulting in Ps. 4 million in the quarter and negative Ps. 44 million cumulatively. I would like to highlight the sequential improvement in EBITDA, which turned positive in the third quarter.

- **[Sales per Country | Others]**

Sales in Central America and Peru decreased as a result of a marked economic contraction and the resulting reduction in demand. However, the effect on our overall results was not significant. Acuantia Brazil's pipeline continues to expand, aided by the new regulatory framework that incentivizes private investments in water infrastructure.

- **[Sales | Products & Services Mix]**

In terms of our portfolio mix, sales of products accounted for 97% of total sales, growing 25% year-to-year. Sales of services decreased 11% despite the accelerated growth of bebbia, due to the factors I outlined before.

- **[Cash Position]**

We maintain a strong balance sheet, which as we have discussed, provides a solid financial platform to both pursue growth and profitability.

Our net debt to EBITDA ratio is 1.6x, slightly lower than that of the previous quarter as a result of the increase in EBITDA and in line with our 2x leverage policy. It is worth noting that our debt position only considers the sustainable bond AGUA 17-2x.

We continue to manage our supply chain to ensure that we have the necessary raw materials to meet the demand for our products, which has increased our cash conversion cycle and our working capital as we continued to see instability in the global supply chains, albeit with relatively stable resin prices.

- **[Discipline in Capital Allocation]**

CAPEX amounted to 5% of total sales in the first nine months of the year, totaling \$452 million pesos. Most of these capital expenditures are being directed at technology to upgrade our core products business, increasing the sustainability of our manufacturing operations and strengthening the leadership position of our brands and increasing their profitability, all of which enables us to continue moving forward with the development of our new businesses as we have already mentioned.

Moving forward, we will continue to be disciplined and agile with our capital allocation and spending, ensuring that we prioritize the key drivers for our sustainable growth and profitability.

- **[ROIC vs Cost of Capital]**

Our ROIC reached 14.4% as of September 2022, 230 basis-points above our cost of capital and exceeding our guidance, bolstering our focus on long-term sustainable value creation and in keeping with the goals set out in the 2020-2025 Sustainable Growth Plan. The cost of capital has increased 40 bps year-over-year.

- **[ESG Initiatives & Progress]**

I would now like to highlight a few key initiatives we undertook in the ESG space during the quarter:

- We successfully concluded our joint pilot project with Acciona, which provided rainwater harvesting systems to support 25 families in Oaxaca.
- We launched the second edition of the Rotoplas-FUNAM award, in alliance with the National Autonomous University of Mexico, UNAM, and the UNAM Foundation. The award seeks to promote research by female students at UNAM on wastewater treatment and recycling and its societal impact.
- 22 of our team members volunteered to participate in Renacer del Suelo, a reforestation effort in Mexico City.
- With regards to Diversity and Inclusion, we conducted a series of workshops and training sessions on the role of women in the workplace and unconscious biases.
- Finally, we concluded the second edition of “El Agua en Debate”, an educational program aimed at increasing awareness of water issues in Argentina. This year, the program reached 864 students and 47 teachers from 36 different schools.

- **[Guidance 2022]**

For our guidance, given our growth and the improvement of our margins, we continue to expect:

- Sales growth greater or equal to 15% for 2022.
- A return on invested capital 100 basis-points above our cost of capital.

- An EBITDA margin between 15.5 and 16.5% and a Net Debt to EBITDA ratio below 2x.
- [AGUA/Closing]

We are committed to the wellbeing of people and planet and the sustainable creation of economic value, leveraging our solid business model and our market-leading brands to pursue new high-potential growth opportunities across the hemisphere. Our company's financial strength and strict capital allocation discipline has enabled us to create value for our shareholders through an improved ROIC as well as dividend payments and stock buybacks. And as we continue to adapt and adjust with the agility brought about by Flow, we will also continue to ensure that we remain at the forefront of the efforts to address the challenges of ensuring access to water in our societies.

- [Q+A]

Thank you very much for your attention. We will now answer any questions you may have.

Operator: You can submit a question by pressing the Q&A button. Please include your name and also the name of your fund or company. We will start with Carlos Alcaraz, Apalache Analysis. Hello. Thank you very much for the call and congratulations on the results. The question is, do you have any estimate on how much operating margins will improve due to recent investments in technology?

Mario Romero Orozco (CFO): Carlos, good morning, and thanks for joining us today. We are aiming to improve somewhere around 190 basis points due to this new technology in manufacturing that we have and that we are expecting to start seeing those benefits going into 2023. And then to your second question, as we have mentioned, all the supply chain instability has created more needs of working capital, despite the fact and explained, we are seeing now more stability on supply chains. So we aim

to improve five days during the last quarter conversion cycle, which equals roughly to around 200 million Mexican pesos.

Operator: Let's move to the to another question. Lucila Gómez from Compass Group. She's asking about the US operations. Considering the US impact on margins, are the pre operating expenses from the septic business and technological expenses for the expansion of the e-commerce platform one-off or should we expect moving forward margins to continue under pressure?

Carlos Rojas Aboumrad (CEO): So, thank you very much for your question, Lucila and thanks for joining. There has been a lot of investment in that opportunity and we believe there's a huge market that is not being very well serviced. And as we are finding traction in that market, we will most likely continue to invest in developing that opportunity. So we expect the US to grow revenues in an aggressive way going forward and the investments for this to happen will follow. So we do see a US business that will have a result that's very close to to break-even, slightly above or slightly below, but that will be growing aggressively in revenues going forward.

Mario Romero Orozco (CFO): And just to complement on what Charlie mentioned, and thanks Lucila for joining us this morning. Yes, margins are going to be under pressure at least for 2023, given our bet on the septic business in the US. So you'd expect, (unaudible), and going into 2024, we think the story is going to be quite different.

Operator: Thank you. Our next question is from Martin Lara, Miranda Global Research. Hi, good morning. Congratulations for the strong results. I have various questions. I will start with the first one. What can we expect in terms of additional price increases during the rest of the year?

Mario Romero Orozco (CFO): Martin, thank you. Good morning. Martin is asking about additional price increases during the rest of the year. Also, what to expect on rising costs for the last quarter and inventory days and supplier days in the fourth quarter. I guess the first one, we won't see more price increases during the rest of the year, only in Argentina to keep up with inflation. But the rest of the countries, I think our set up in pricing

is good and the gross margin in the third quarter speaks out on that. Rising costs on fourth quarter is going to be very similar to the third quarter. And finally, on inventory days, I think we already addressed that. We are expecting to reduce five days our cash conversion cycle, which represents roughly \$200 million pesos. So those \$200 million pesos will be a positive cash flow effect going to the closing of the year. So thanks again for joining us this morning. I hope we have answered your questions.

Operator: We have Felipe Barragán from BTG Pactual. Hi, Mario and Carlos. Congrats on the results. I have a question on the pricing strategy in Argentina. Inflation is obviously high in the country. Could you give us a little more color on what strategy are you implementing to capture greater profits? And also, how often are these pricing changes? Does the profit spread change significantly in each of these pricing changes?

Carlos Rojas Aboumrad (CEO): Thank you very much for your question. And thanks for joining. Argentina is a very different market to the rest of our markets that we participate in. We're now experiencing high inflation all over our markets, but Argentina is in a whole different level. And I think we have been operating that country very successfully and we've been able to increase prices very successfully in the past multiple quarters and the way we do it is we're always leveraging the strength of our brands. We have three different brands that are leading brands in Argentina. With the strength that we have from these different brands that we integrate, and we go to the customer as one company, integrating these three different lines of products, we are able to increase prices in alignment with inflation in advance. And so we have been very profitable in Argentina for the past few years doing that. We will continue to do that and that is mainly the strategy for Argentina. But it is a very dynamic practice in terms of frequency. It's almost monthly. It's a very dynamic practice as compared to the other markets. Mario, anything else that you like to share?

Mario Romero Orozco (CFO): No, you nail it out. It's a very different market and pricing is done on a monthly cadence.

Operator: We have another question about CapEx. What will be the priorities for the remainder of the year and for 2023?

Carlos Rojas Aboumrad (CEO): Well, we are investing very heavily in the core of our business, particularly in storage, on the water storage solutions. So that will continue to be the main focus. Fortunately, we've seen more traction in water treatment plants in terms of interest from new customers. So that will be another one that we will be investing in going forward. But the main one is on products. Mario and anything else that you like to share.

Mario Romero Orozco (CFO): Complementing Charlie's answer. Most of the CapEx is already committed and it's aimed as we're explained to update our portfolio solutions, mainly in water storage. So CapEx is being executed. We expect to close the year at a CapEx percentage to sales in the neighborhood of 6%. That's where we're going to be landing for 2022 and most of the CapEx is already compromised. As you know, CapEx cannot be booked until the investment phase is concluded. So as we speak, we are running into that and suspect somewhere around 6% for year-end.

Carlos Rojas Aboumrad (CEO): Maybe it's worth remembering our guidance for 2025, which is having a return on invested capital in the ballpark of 20% and having 200 basis points above weighted average cost of capital. So just wanted to mention that our CapEx is in alignment to get into that target by 2025.

Mario Romero Orozco (CFO): And then just on the other side of the question, on 2023, we'll obviously speak with more detail on the AGUA Day that will be at the beginning of December. But the priorities, we were prioritizing the same we did this year and last year. We have a bunch of initiatives that are coming from our transformation program. Some of them have our CapEx all very aligned to our strategy. So you'd expect pretty much similar to what you've seen in 2022.

Operator: Regina Carillo from GBM. Hi. Congratulations on the results. Can you give us a little bit more color on how bebbia behaved during the quarter? And on the long term, has the expected time of break-even has changed?

Carlos Rojas Aboumrad (CEO): Thank you very much for your question, Regina. In terms of the quarter, it continues to grow in terms of new subscriptions. The amount of new subscriptions per quarter continues to grow and obviously the total number of customers continues to grow. It grows at similar rates, so in terms of volume, it's much larger volumes. And in terms of the break-even, it is not changing. But again, since we are having the installation cost and the product cost be a cost of the solution on day one, the more we grow, the higher the investment, so it is a business that will have negative EBITDA for whatever the period is that we're growing at this accelerated rates and we're expecting to be growing at this accelerated rates all the way through and beyond 2025. So, Mario, I don't know if there's any other information that you'd like to give regarding bebbia.

Mario Romero Orozco (CFO): I think you got it right. Nothing to to compliment your answer.

Operator: Okay. The next question is from Mauro Mauleon, from NAFIN, and his question is about the riego business. Could you please share the status and vision for the next years?

Mario Romero Orozco (CFO): Sure. Thank you for joining us this morning. Well, the vision for the next year is pretty much what we have explained to you guys in previous calls. It's a space we like very much because of what are the needs to improve water management in that space. And obviously the growing pace of the agriculture as a total. The performance, we will keep on developing the market. For the first nine months, sales have grown more than 10x vs. 2021, but obviously the base is very small, so it is easy to grow at that pace, but what we've been understanding is that there is a huge need for technology and new ways to manage the agricultural business.

Operator: We have a question from Rodrigo Salazar, AM Advisors. Hello. Thank you for the call. Can you talk about your expectations going forward in the region reported as others, do you expect an improvement in demand and consequently in margins? And then he has another question.

Carlos Rojas Aboumrad (CEO): Let's take that one first and then we'll go to the next. But thank you very much for joining us Rodrigo and for your question. In terms of demand for the other countries, which is Central America, Peru, and Brazil mainly. Demand will continue to grow in the longer term, not in the short term, though. The short term will be impacted by macroeconomic performance of the whole region. I think we need to wait and see what's going to happen in the whole region in terms of macroeconomic performance. But in terms of water scarcity, which is a big demand driver, it continues to get more challenging, generating more demand going forward. Brazil, particularly, we're in the water treatment business and Brazil has seen some major changes in terms of the regulation which promotes a higher consumption of these kinds of water treatment plants, which is centralized water treatment plants. And so we do expect demand to also continue to grow in Brazil. Mario, regarding demand for other countries?

Mario Romero Orozco (CFO): I will just add that you will see an improvement going into fourth quarter on margins and 2023 will make their comeback, mainly because of Central America, which, as Charlie explained, has been badly hit by economic performance and some political instability in some of those countries. Brazil is going to be a developing business which will be negative EBITDA, while we keep on building the water treatment and recycling businesses.

Operator: Perfect. And the other question is about Flow expenses. If we expect to have those expenses for the remainder of this year. And where can we see the benefit of these expenses finishing? How big can the change be?

Mario Romero Orozco (CFO): Well, as you know, Rodrigo, we are not adding up this year Flow expenses to the adjusted EBITDA as we did in 2020 and 2021. So for next year, what you're going to be seeing is a decrease in SG&A because we will not be doing more of this one timers. So you'd expect a better EBITDA performance for 2023.

Operator: That was the last question.

Mario Romero Orozco (CFO): And I'm sorry Rodrigo, thanks for joining us this morning. We didn't thank you for being this morning with us.

Operator: Okay, so you can submit a question by pressing the Q&A bottom. We can just give like some seconds and if we don't have any more questions we can close the webcast. I would say that was the last question. So thank you, Mario. Thank you, Charlie.

Carlos Rojas Aboumrad (CEO): Thank you very much, everybody.

Operator: Thank you, everybody for joining us and see you next quarter.

Mario Romero Orozco (CFO): Thank you. Have a great day. Bye bye.