Grupo Rotoplas

3Q24 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 Mr. Mario Romero, Former CFO and Board Member and Mr. Andres Pliego, Incoming Chief Financial Officer. I will now turn the call over to the speakers.

Carlos Rojas Aboumrad

Before we begin today's agenda, I want to express my gratitude to Mario and warmly welcome Andrés.

Mario, your dedication over the past 30 years at Rotoplas has been remarkable. Your leadership achieved significant milestones—from taking us public to issuing our sustainable bond—and your commitment to sustainability has left a lasting legacy.

Thank you, Mario. We're deeply grateful and look forward to your continued impact on our Board.

At the same time, we're excited to welcome Andrés as our new CFO and look forward to his leadership in this next phase.

Mario Romero

Good morning, and good afternoon to those of you in different time zones. I want to sincerely thank Rotoplas and our entire team for an incredible journey over the past 30 years. It's been a privilege to work alongside such brilliant colleagues.

Together, we've navigated challenges and celebrated achievements I'm truly proud of. I'm also grateful to our analysts and investors for their trust and insights.

As I continue to serve on the Board, I'm pleased to welcome Andrés Pliego. I'm confident he will be an excellent fit and will continue to execute Rotoplas' financial strategy with dedication, keeping us on track toward our long-term vision.

Thank you all.

Carlos Rojas

Thank you, Mario. Let's begin by reviewing the key highlights of the quarter. After covering what happened and the reasons behind it, I'll shift our focus to the steps we'll be taking to improve profitability as swiftly as possible.

It was indeed a challenging quarter. Similar to the previous two quarters, the harsh economic situation in Argentina impacted our results, primarily due to a drop in sales that has affected our profitability, given the fixed cost structure we have in place. However, unlike the previous quarters, while all other countries showed growth, in Mexico—our main market—we saw a slowdown in product sales due to heavy rains.

We faced extreme rainfall—the highest in over 80 years in some areas—which severely reduced demand for our water storage solutions. We believe this is tied to weather cycles rather than market issues, but we'll monitor these patterns closely. I have no doubt these extreme weather events will continue. We need to be more agile and flexible in demand planning and supply chain management. This way, we can anticipate and adjust our costs to maintain greater stability in our operating results.

Despite these headwinds, our services platform showed strong growth, driven by the expansion of bebbia and the successful launch of bebbia SMART, which has been well received by our customers.

Argentina remains one of our greatest challenges. The country's challenging economic environment, marked by high inflation and declining consumer purchasing power, is impacting both the construction sector and our overall performance. However, there is potential for recovery. Inflation, though still high, is expected to decrease to around

65% by 2025, as fiscal and monetary policies take effect. The World Bank forecasts Argentina's economy will rebound with 2.6% growth in 2025, driven by improved agricultural exports and structural reforms.

Given the current challenges, we already have made a strategic decision to optimize both expenses and investments in the coming quarters. Our goal is to maintain a strong financial foundation while positioning ourselves for the next phase of growth. This includes slowing down non-essential investments, prioritizing projects that directly impact margins, and implementing targeted cost-saving initiatives across our operations.

Our strategic priorities are:

1. Capitalizing on omnichannel and digital capabilities, such as the bebbia 3.0 platform and our e-commerce platforms for distributors in Mexico.
2. Reversing the decline in EBITDA trends by reducing expenses.
3. Focusing on higher operating profit to increase free cash flow generation through working capital optimization and strict capital expenditure control.

As part of our ongoing review, we updated our 2024 guidance in response to current market conditions, with a revision in September. Andrés will provide more details on these adjustments shortly.

While we acknowledge the challenges before us, we are optimistic. We are confident that our strategy—focused on operational excellence, sustainability, and a customer-centric approach—will create value in the coming quarters. Our investments in technology, digitalization, and sustainable infrastructure position us well to seize emerging opportunities.

An example might be the National Water Plan proposed by the new government, which aims to address Mexico's water management and distribution challenges with a strong emphasis on efficient irrigation and wastewater treatment.

We remain committed to navigating these challenges with resilience, always focused on long-term success.

Also, sustainability remains a top priority. I'm proud to share that during the quarter, we've transitioned to 100% renewable electricity at two of our main plants in Monterrey, adding to the two in León, bringing our total to four fully renewable-powered facilities. We've also improved our Corporate Sustainability Assessment by S&P Ratings, placing us among the top five globally in our industry. Additionally, with JP Morgan's support, we issued Latin America's first and the world's second SDID report, disclosing our impact on the UN's 2030 SDGs.

Through the Rotogotas de Ayuda campaign, we donated over 1,400 water tanks to drought-affected communities in Mexico. Additionally, the *Escuelas con Agua* program, in partnership with the Coca-Cola Mexico Foundation, the eight bottlers of the Mexican Coca-Cola Industry, and Isla Urbana, is installing rainwater harvesting systems in schools to provide sustainable water solutions.

Thank you for your attention. I'll now hand it over to Andrés to discuss the financial details. Andrés, over to you.

Andrés Pliego:

Thank you, Charlie and Mario, and welcome to everyone joining us today. I'm truly excited to embark on this new journey with Rotoplas. I look forward to collaborating closely with all of you—investors, analysts, and stakeholders—and I hope to connect with each of you individually soon.

To kick it off, and although Charlie has already highlighted the key points, I'd like to recap how things unfolded in the third quarter:

In a nutshell, the economic recession in Argentina significantly impacted our sales, and unlike the previous quarter, this was not offset by product performance in Mexico due to heavy rains.

This combination of demand challenges in both Argentina and Mexico affected our ability to absorb fixed costs and expenses. Additionally, it's important to note that we have been investing in several digital and technology projects this year, while also contending with rising logistics costs driven by global geopolitical factors.

Finally, the weakness in our operating results was unable to cover our financial costs, leading to a net loss for the quarter.

Excluding Argentina, our sales would have grown by 4% in the quarter. On a cumulative basis, the group would have achieved an 8% growth rate.

With that in mind, I'll quickly go over the key results, focusing primarily on margins, as we'll dive into more detail on top-line performance in the following slides.

As for margins, we saw a contraction of the gross margin during the quarter due to lower revenue. However, on a year-to-date basis, we still see an increase, thanks to our pricing strategy and strong sales of Tinaco Plus+, which significantly boosted margins during the first half of the year.

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 September 2024, the margin was affected by 50 basis points.

Our operating margin deteriorated both during the quarter and on a cumulative basis. This was primarily due to sales not meeting expectations, as previously discussed, with macroeconomic challenges and climate conditions playing key roles. In addition, logistical costs continued to rise, and we invested significantly in digital initiatives and marketing for bebbia, all of which put further pressure on margins.

Moving on to performance by country. Sales in Mexico grew by 2% during the quarter and 11% year-to-date, supported by growth in product sales and strong performance in the service segment.

After record storage sales in the second quarter, driven by drought-related demand, the third quarter saw a shift as heavy rains reduced the need for water tanks and cisterns. Additionally, the wet season negatively impacted the construction industry, slowing or halting activity, which in turn dampened demand for other water management solutions.

EBITDA margins contracted, primarily due to higher operating expenses and the softer sales performance in the third quarter.

In Argentina, net sales decreased by 26% in Mexican pesos during the quarter and by 31% year-to-date. This decline is mainly attributed to the ongoing economic recession, which has impacted both sales volumes and pricing. However, in the third quarter, we saw a slight improvement in volumes compared to the second quarter, indicating a slight recovery. Despite this, lower sales combined with dollarized expenses continued to put pressure on margins.

In the United States, net sales increased by 1% in Q3 and declined by 10% year-to-date, primarily due to the lack of drought conditions and intensified competition. However, cost control measures contributed to reducing negative EBITDA during both the quarter and year-to-date periods. While the EBITDA margin remains in the red, it is gradually improving and moving closer to breakeven.

In other countries, net sales rose by 15% in Q3 and 7% year-to-date. In Peru, despite macroeconomic challenges, sales were boosted by strong demand for water heaters due to a colder winter. Central America showed solid growth, with Costa Rica and Guatemala performing well across the key categories of storage, waterflow, and improvement.

In Brazil, water treatment and recycling plant projects continue to expand, with growth in bookings and a more diverse client base.

The decrease in EBITDA margin for other regions was primarily driven by rising operating costs, particularly in logistics and distribution. Additionally, the development of the water treatment plant business in Brazil added to the increased expenses, contributing to the margin contraction.

In terms of our product and service performance, the services segment now represents 8% of our total revenue.

Within this area, we have made significant strides:

- **bebbia** has greatly extended its reach, now serving over 127 thousand users, demonstrating our strong growth in the consumer water solutions market. In August, we introduced bebbia SMART, which has received excellent feedback. Customers appreciate having instant access through a mobile app to data on their water consumption and the quality of the water their families are consuming. By September, 25% of new subscriptions in areas where it's available have opted for this new smart service.

- Rieggo, both organically and now also through inorganic growth, has served 165 clients, covering approximately 400 hectares of high-value crops.

- RSA has increased its scale and reach, while Acuantia Brasil shows promising growth prospects due to ongoing processes with a high likelihood of closing.

Regarding the EBITDA margin, it improved both in the quarter and on a cumulative basis.

Moving on to our cash position. As of the end of September, our cash and cash equivalents were 616 million pesos. Our net debt to EBITDA ratio stood at 2.1 times, slightly exceeding our internal limit of 2 times, we view this as a temporary level, and we expect it to fall below 2 times in the near term.

The company remains financially solid, and we will continue to be strategic in managing both sides of the equation—controlling debt while also focusing on improving profitability.

Our total debt amounts to 4.4 billion pesos, distributed between short-term and long-term to maintain financial flexibility. Short-term debt stands at 315 million pesos, mainly allocated for working capital to efficiently manage day-to-day operations. Long-term debt is 4 billion pesos, which includes the fixed-rate sustainable bond. The overall blended cost of debt is 8.8%.

In addition, we have optimized our cash conversion cycle by 4 days, and our interest coverage ratio remains above 6 times, demonstrating our capacity to meet interest obligations.

During the first nine months of the year, our capital investments represented 4.5% of sales, marking a significant 39% increase compared to the same period last year, with 92% allocated in Mexico. We focused on incorporating new technologies for more sustainable water tank production, as well as the construction of a new plant in

Ixtapaluca. Additionally, we invested 90 million pesos in bebbia and 29 million pesos in the development of water treatment and recycling plants.

Our Return on Invested Capital was 10.3%, which is 40 basis points below our cost of capital. While we've increased our investments, our focus in the coming quarters is to enhance NOPAT to regain a positive spread between ROIC and WACC. We remain committed to implementing strategies that enhance profitability and create lasting value for our shareholders.

Finally, as we look ahead to the last quarter of the year, the prolonged economic recession in Argentina—recovering more slowly than expected—will continue to impact our performance. Therefore, for the full year, we are estimating:

- Revenue growth between flat and a 5% decline
- EBITDA margin between 14% and 15%
- Leverage between 2.0 and 2.2 times, and
- ROIC estimated to be 100 to 200 basis points below our cost of capital

We are navigating current challenges to position the company for future success. As Charlie mentioned, our strategic priorities are to reverse the decline in EBITDA trends through expense reduction; and focus on higher operating profit to increase free cash flow via strict capital expenditure control.

Thanks for your time and interest. We can now begin the Q&A session.

Operator: You can submit a question by pressing the Q&A button and including your name and company. Let's get started. Our first question comes from Carlos Alcaraz at Apalache Research, and it's about Capex. The question is: What percentage of revenues are you allocating to Capex next year?

Carlos Rojas Aboumrad (CEO): Thank you. Mario and I will be handling the Q&A. I'll start by thanking you, Carlos, for joining us and for your question. Regarding Capex, we'll approach it a bit differently than in the past. We'll maintain maintenance Capex as the essential Capex needed to sustain the results we're achieving and the opportunities the market presents. However, all other Capex will be approved on a month-by-month basis. We're raising the threshold for Capex approval, meaning that discretionary spending not deemed essential will be reviewed monthly. Mario, do you have a more specific figure for maintenance Capex?

Mario Romero (Former CFO): Thanks, Charlie. Let me add to that. Good morning, Carlos, and thank you for joining. A good way to visualize our Capex strategy for next year is that, on the product side, we'll focus only on maintenance Capex. Our platform and equipment are highly modern, and the transition to new smart water tanks has already been implemented. So for the products division, as Charlie mentioned, our Capex will be maintenance-only, which should range around 1.5% to 2% of revenues.

For the services business, we're adopting a "pay-as-you-grow" strategy. Among our three business units—bebbia, each new unit fuels growth. So, as Charlie mentioned, we'll release or allocate Capex as growth occurs. The same applies to water treatment plants; each additional unit will be reviewed before allocating Capex. Rieggo, meanwhile, is a Capex-less business. So overall, our services strategy is "pay-as-you-grow." For your model, 3% of total company revenues is a good proxy for forecasting.

Operator: Thank you. Carlos has another question: What is the progress percentage for the Ixtapaluca plant, and what is the estimated total investment?

Carlos Rojas Aboumrad (CEO): Most of the project is complete, and manufacturing has begun at Ixtapaluca. We still have a transition from the old plant to the new one. As for investment details, we're unable to share specifics for Ixtapaluca. Mario, can you shed light on additional Capex spent transitioning to the Tinaco Smart?

Mario Romero (Former CFO): Unfortunately, we don't disclose that figure for strategic and competitive reasons.

Carlos Rojas Aboumrad (CEO): Let us get back to you, Carlos, with a way to provide more information on how much we're investing in our products business through maintenance Capex.

Operator: Thank you. Moving on, we have a question from Bernardo Malpica at Santander Asset Management regarding EBITDA and Mexico. His question: How much of the EBITDA margin contraction due to digital initiatives is expected to be one-time, and how long will it impact future quarters? Will digital initiative investments significantly affect the 2025 EBITDA margin?

Carlos Rojas Aboumrad (CEO): Hello, Bernardo, thank you for your question and participation. Regarding digital and IT investments, we expect them to decrease next year, though they'll remain higher than in previous years as we shift spending from traditional to new practices. For example, a department may be automated, reallocating savings to cover new solution licenses, which fall under Opex. Initially, digital solutions may impact Capex, but eventually, they transition to Opex. Capex in IT and digital will decrease for the remainder of this year and into next year.

Operator: Thank you. Next, we have Sofía Martín at GBM, who has three questions. Here's the first: What should we expect from Argentina in the coming quarters and years?

Carlos Rojas Aboumrad (CEO): Thanks, Sofía. Argentina's outlook is uncertain, but I expect the country to regain economic growth. Some key structural changes are underway, and if certain political milestones are achieved, Argentina may see a successful transition. We're now making decisions for Argentina more flexibly, on a monthly basis. Argentina remains a key market where we've invested significantly in working capital to protect our investments over the past 20 years. Our market share is strong, and we expect working capital to improve, supporting cash flow. In terms of volume, we're cautiously optimistic about a rebound. Mario, any additional thoughts?

Mario Romero (Former CFO): Yes, Charlie has summarized it well. Argentina's macroeconomic factors are crucial, and the Company is in a strong position. We lead in all three segments, and we have enough capacity to double our sales if demand recovers. The key question is timing—whether Argentina's recovery will come in 2025 or later as the country transitions to a new economic model.

Operator: Thank you. Sofía's second question is: When should we expect a break-even from the services division?

Mario Romero (Former CFO): Good morning, Sofía. For the services unit, we need to break it down. Rieggo is profitable this year. Our water treatment and recycling plants in Mexico and Brazil will reach profitability in 2025. As for bebbia, it's growing rapidly, which delays profitability. If we halted growth, bebbia could be profitable immediately, but our strategy is to expand while the market is growing. We expect bebbia to reach profitability by 2026.

Operator: Thank you. Now for the next question from Sofía and Martín Lara about debt levels: What strategy do we have moving forward?

Mario Romero (Former CFO): As Andrés mentioned earlier, we expect to address this within six months by leveraging various internal resources, which will lower our debt below the two-times ceiling.

Carlos Rojas Aboumrad (CEO): Complementing Mario's answer, we aim to grow EBITDA by enhancing efficiency, which will improve the net debt-to-EBITDA ratio. We also plan to reduce investments, thus lowering cash needs and debt. This is a short-term transition.

Mario Romero (Former CFO): Additionally, inventory reductions in Argentina and Mexico, as well as asset sales, should free up cash. This, along with EBITDA growth and reduced SG&A, will help stabilize our balance sheet.

Operator: Perfect. Next, Martín Lara has a question about bebbia: How do you see this service evolving over the next few quarters, and are there plans for new features or expansion?

Carlos Rojas Aboumrad (CEO): We've heavily invested in enhancing our digital platform, which is in the testing phase and will launch soon. Incremental improvements will follow. bebbia's growth is robust, and we'll prioritize this segment, as it shows solid fundamentals and strong customer demand.

Operator: The next question is from Felipe Barragán at BTG. He asks: Why did the services segment slow down, even though programmatic M&A contributed significantly to year-over-year growth?

Carlos Rojas Aboumrad (CEO): Mario, could you clarify?

Mario Romero (Former CFO): Certainly. Felipe, the slowdown mainly resulted from Rieggo's project delays due to drought. Now, with the rainy season, Rieggo is picking up again, complementing our water storage business.

Operator: Thank you. Felipe also welcomes Andrés and asks about his plans and strategies for Rotoplas.

Andrés Pliego (Incoming CFO): Thank you, Felipe. My short-term focus will be on balance sheet discipline, particularly on liabilities and working capital. Managing costs and expenses is also crucial, especially amid macroeconomic challenges.

Operator: Thank you, Andrés. Rodrigo Salazar has questions on margins and growth in various regions, especially Argentina. Can you clarify why Argentina's margins decreased despite quarter-over-quarter sales growth?

Mario Romero (Former CFO): Thanks, Rodrigo. We reduced prices in Argentina to boost volume, which explains the revenue increase but lower EBITDA margin. Argentina is shifting to a competitive economy, impacting pricing strategies. We're implementing pricing strategies similar to those in Mexico to adapt.

Operator: Rodrigo also asks if you could elaborate on the Company's strategic shift.

Carlos Rojas Aboumrad (CEO): The core strategy remains the same, with a focus on growth in Mexico, our core business, and our services segment. We also see potential in the U.S. market. However, we're adjusting how we manage expenses and investments given the current margin environment.

Mario Romero (Former CFO): Adding to Charlie's point, the Company is exiting a heavy Capex cycle, allowing us to capitalize on existing assets for sustainable growth.

Operator: Thank you, Carlos, Mario, and Andrés. That was the final question. Any closing remarks?

Carlos Rojas Aboumrad (CEO): Thank you, Mario, for your contributions, friendship, and support over the years.

Mario Romero (Former CFO): Thank you, Charlie. It's been a pleasure working at Rotoplas. I'm grateful for these 30 years and optimistic about the Company's future. Thank you, everyone, for your questions and support. Goodbye.

Operator: Thank you, everyone. This concludes our Q&A session and the webcast. You may now disconnect. Have a great day.