

Grupo Rotoplas

Fourth Quarter 2016 Conference Call

4Q16 Rotoplas Conference Call

Operator:

Good morning and welcome to the Grupo Rotoplas fourth quarter 2016 results conference call.

Please note that today's call is being recorded and all participants are in a listen-only mode to prevent background noise. Later we will conduct a question and answer session. I would now like to turn the call over to your host for today, Mr. Esaú Gallegos, Grupo Rotoplas' Head of Investor Relations. Mr. Gallegos: Please go ahead.

Esaú Gallegos:

Thank-you, [operator name]. Good morning everyone and thank you all for joining us today. Yesterday we issued our earnings press release after market close. The release can be found on the IR section of the Rotoplas website. As usual, we've provided slides to supplement our discussion. These slides can be also accessed on our website under investor information.

Before we start, let me remind everyone that today's discussion contains forward-looking statements based on the environment as we currently see it and as such does include risk and uncertainty. Please refer to our press release for more information on the specific risk factors that could cause actual results to differ materially. The Company disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, further events, or otherwise.

I'm joined today by Mr. Carlos Rojas, Rotoplas' Chief Executive Officer, and Mr. Mario Romero, Chief Financial Officer. We'll begin our call with prepared comments and then we will open it to Q&A.

I would now like to turn the call over to Mr. Carlos Rojas. Mr. Rojas, please go ahead.

4Q16 Conference Call Script

Carlos Rojas Mota Velasco:

Thank you Esaú, and thank you everyone for your continued interest in our Company. We appreciate you joining us this morning and trust you will find that we will be sharing with you interesting information.

As you know, 2016 was the second year since Rotoplas became a public Company. We are very proud of the hard work we have done over these two years, and of the goals we have reached.

Despite the challenges prevailing in the markets where we do business, we took the appropriate measures needed to ensure value creation during this period. As an example, we managed to shift our emphasis towards our most profitable solutions, that offer better growth opportunities. At the same time, we continued to build a solid platform of integrated solutions through which we offer our clients in the private sector the added benefit of our maintenance services. We are sure that this platform will represent the milestone for the value creation in the following years.

In line with what we have stated in previous quarters, during 2016 we faced economic and political circumstances that presented considerable challenges in the markets we serve. However, based on our strategy and the strong dynamics of our portfolio of solutions, we were able to overcome and reduce the impact of external conditions.

A clear example of this, is our previous dependency on sales related to government-funded programs. Over the course of these two years, in order to offset the impact of being reliant on this particular segment, we relied on the flexibility of our business model to shift gears rapidly and reduce our government-related sales. Currently they account for less than 5% of our total sales, down from the more than 40% in 2014. For the following years, the estimates of the Company for this channel is to represent less than 10% of consolidated sales.

Based on this strategy, we are proud to say that over the past two years our organic sales, excluding government-related sales, have consistently registered double-digit growths, attesting to the strength of our core business.

Other significant events in 2016 include the acquisition of three companies: Talsar, AIC, and Sytesa.

4Q16 Conference Call Script

Talsar is an Argentinian company that complements our portfolio and creates cross-selling opportunities within our individual solutions, particularly in the water storage segment.

In Chile, we acquired a minority stake in Advanced Innovation Center (AIC), a company offering state-of-the-art water purification technologies unlike any other in the world, through which 100% of microorganisms are purified. We are very optimistic of the results we can obtain by integrating this technology into our solutions in the coming future.

Finally, by acquiring the Mexican company Sytesa, we strengthened our position in the water treatment and water recycling markets for decentralized private sectors, making us the leading company in the Americas in terms of plant count.

We are certain that all three acquisitions will make a strong contribution to ensuring value creation at Rotoplas in the years to come, as they all bring their own set of strengths to the Rotoplas platform.

Before turning the call over to Mario, who will talk to you in detail about our financial results, I would like to touch on a few of the most relevant issues for the year.

Mexico sales were affected by delays in public spending which affected our sales of integrated solutions to government-funded programs. However, it is important to mention that during the last quarter, we started to recognize income related to the Water Purifying Fountains Program.

Brazil's results continued to be affected by the economic and political situation in the country. In response, our management team took the necessary measures to adjust the business model to the current sales and costs levels, to minimize the negative impact. On the positive side, in late 2016, we began to see contract re-activations, and we were able to collect more than 50% of the pending accounts receivable, with the remaining expected for 2017. Although we will not focus our operations towards serving this channel, we will be able to again serve the government channel demand when the opportunity arises.

It is also important to mention that income generated in the Other Countries division increased 56.2% when compared to 2015. This is mainly the result of positive growths in water storage solutions for the retail channel in the region, and partly also due to the acquisition of Talsar. In this scenario, Argentina became the second largest contributor to the Group in terms of EBITDA creation. Excluding the sales from the acquisition, the Other Countries division sales increased 10.1%.

4Q16 Conference Call Script

Looking forward, we are focused on our goal of doubling the size of our business over the next 4 years, while government related sales were reduced to its minimal expression and should stay below 10%, based on the strength of our brand coupled with the prospects of clear growth opportunities.

For the following years, we expect to keep growing supported first, by an increase of our market share in the US—which represents an enormous opportunity for the water and sanitation segments—and, second, by building a solid platform focused on serving the segments where we offer integrated solutions with maintenance services, which include the drinking water fountain program in Mexico, and the water treatment and recycling plants businesses, which are already contributing to our results. Finally, we will continue to capitalize on M&A opportunities that could contribute to creating synergies with our current portfolio.

With that, let me turn the call over to Mario who will take you through our results.

Thank you very much.

4Q16 Conference Call Script

Mario Romero Orozco:

Thank you Carlos, and good morning everyone. I will now take you through the financials for the fourth quarter and for the whole of 2016 in more detail. As you know, we will then turn the call over to you and we will be happy to respond to any questions you may have.

As we have discussed, during 2016 we faced challenging political and economic environments in the main markets we serve. However, by shifting our emphasis to solutions with a better margin, we managed to maintain profitability.

Net sales increased 3.4% during the quarter, supported by a 17.8% increase in the sale of individual solutions, which accounted for 86% of sales. This growth was mainly due to increased demand in the retail channel in Mexico, to the recognition of income related to the water fountains program, as well as to higher sales in the Other Countries division, in part as a result of the inclusion of Talsar's results in Argentina. Individual solutions accounted for 86% of the total sales.

Integrated solutions represented 14% of total sales and decreased 40.1% during the quarter, due to the continuing effect of public spending delays in Mexico and continuous political and economic problems in Brazil.

Gross margin increased 140 basis points during the quarter, because of better selling prices and higher sales volume. On the other hand, operating margin was affected by the expenses incurred in the market penetration effort in the United States Market that totaled 20 million for the quarter, as well as in the continuous efforts of downsizing our operations in Brazil, for 6 million pesos approximately. Due to this, and because of higher depreciation related to the acquisition of Sytesa, our EBITDA margin was up 50 basis points.

As you will remember, we started incorporating Sytesa's results in our consolidated results in September 2016, under the integrated solutions segment. This business serves commercial clients exclusively such as hotels, office buildings and big box stores.

Moving to the 2016 full year results, net sales decreased 6.1% when compared to 2015, derived only from lower demand of integrated solutions by the government clients, given the challenging economic environment that faced throughout the year.

Individual solution sales during the year accounted for 92.8% of total sales and increased at a double-digit rate of 10.9% despite a drop in the retail channel in Brazil of 28%. The growth

4Q16 Conference Call Script

mainly came in Mexico and in the Other Countries division, driven particularly by organic sales growth and individual solution sales in Argentina. On the other hand, integrated solutions decreased 68.4%, resulting from the economic and political situation previously described. Excluding Sytesa, integrated solutions decreased 76.5%.

Gross margin increased 180 basis points given the better selling prices and volume recorded during the year, and the incorporation of integrated solutions with better margins. On the other hand, the operating margin decreased 80 basis points, due to fixed costs and one-timer expenses recorded in Argentina and Brazil, in the amount of 16 million pesos

Despite the lower sales, EBITDA margin increased 30 basis points, supported by organic growth and as a consequence of higher depreciation coming from the acquired companies made during the year.

It is worthwhile mentioning that despite the decrease in sales in the year, net profit margin increased 130 basis points year-over-year, and in the last twelve months, earnings per share increased 11.9%. In fact, our net income of 451 million pesos is the highest recorded for the Company.

Also, two years after our IPO, we have invested already 3.1 billion pesos, representing approximately 77% of the raised money, which proves that despite the complex environment, the water market still presents interesting growth opportunities for Rotoplas.

Year to date we keep a strong cash flow to continue with our disciplined capital deployment to drive total shareholder return. After net profit and excluding acquisitions, our Free Cash Glow reached 329 million, representing a 6.2% of the sales of the year.

We remain focused on ensuring consistent value creation for our stakeholders, as we work to increase our footprint in the water industry through exploring new markets and strengthening our business model with a service structure and recurrent sales, thus giving stability to our financial performance.

As for our guidance for 2017 and given how we have reconfigured our business portfolio in the past two years with more recurrent businesses and less exposure to volatility coming from government sales. We feel confident that we will deliver double-digit growth in Sales and EBITDA while net income will come along the same lines; working hard to post a record year for the company despite some headwinds coming from world economic and political uncertainties. This growth will come mainly from Mexico & Other Countries with healthy

4Q16 Conference Call Script

demand for individual solutions, market penetration for water treatment & recycling plants and revenues coming from the already signed water fountains that experienced a series of bottlenecks in 2016; while Brazil will recover from 2016 bottom levels. In terms of sales breakdown, what we can comment is that we do not expect more than 10% of the revenue coming from government related sales and that 50% of them are already contracted.

I would now like to turn the call over to the question-and-answer session. We will begin by answering questions made by those of you participating in the Conference Call, followed by questions received via our website. Operator, please go ahead.

Operator:

Yes. If you would like to ask a question over the phones, please press the star key, followed by the digit one on your touch-tone telephone. Again, it is star, one to ask a question. Also, please make sure your mute function is turned off to allow your signal to reach our equipment.

We will take the first question today from Adan Rodriguez with GBM. Please go ahead.

Adan Rodriguez:

Hello, and thank you for taking my questions. I would like your input on two matters, if I may. First, when do you expect the second phase of the water fountain program to begin and do you have a goal for the second phase? Secondly, we saw significant margin expansion during the latest quarter due to the new strategy implementation in integrated solutions. Can you give us a more detailed outlook on 2017 for the solution, please?

Mario Romero Orozco:

Thank you, Adan, for your question and good morning. Well, as for the water fountains, let me explain in detail. As you may know, we get contracts for 3,200 water fountains in 2016. From them, we only start recognizing revenue from 20% of them. The reason was some bottlenecks experienced on the way. We need to collect signatures from the schools, government and so on. So, we expect in 2017 to finish those 3,200 and start recognizing revenue. As for the new program, we understand that they want to do 11,000 more water fountains for 2017 and we expect Rotoplas could be a good player attending—a good part of them.

4Q16 Conference Call Script

As for the second question, Carlos Rojas will comment on it.

Carlos Rojas Mota Velasco:

As we have mentioned, we have a focus in our business to develop business unit in integrated solutions which includes maintenance, like these water fountains and like water treatment plants, and because of the complexity of this service they are going to have better margins and we have had a growth in this area and we are developing growth for the future in these areas. So, that's the main reason for these margin expansions, Adan. Thank you for your question.

Adan Rodriguez:

Okay, thank you. Just a follow-up question, if I may. On your guidance you said that sales and EBITDA are expected to have double-digit growth; however, is EBITDA expected to have a higher double-digit growth due to margin expansion?

Mario Romero Orozco:

Yes, that could be the case.

Adan Rodriguez:

Okay. Thank you for your input.

Operator:

We'll go to Pablo Ricalde with Merrill Lynch.

Pablo Ricalde:

Hi. Good morning. Thanks for the call. I have a question related to Brazil. You mentioned that you're expecting improvements from 2016 low level. Are you assuming breakeven results for the year or you still expect varied EBITDA coming from Brazil?

Mario Romero Orozco:

4Q16 Conference Call Script

Hello, Pablo. Thanks for the question. The Company has a goal to achieve breakeven. As we mentioned in the previous call, we have already signed, for some contracts are being reactivated for integrated water solutions particularly rainwater harvesting, so that will help in the revenue level of the country. On the other hand, we are starting to see some consumer pickup on the demand, so that will help the retail business. So, probably two parts to it will help Brazil head toward breakeven for 2017.

Pablo Ricalde:

Okay, thanks.

Operator:

We will now take a question from Ulises Argote with Santander.

Ulises Argote:

Hi, guys. Thanks for taking my question. In terms of pricing on the individual solutions, are you planning to do any increases to offset pressure in margins from FX or what would be the approach that you're taking there? Thanks.

Carlos Rojas Mota Velasco:

Yes, Pablo. We have already done some price increases at the end of last year and they have been reflected because of mainly the exchange rate increase. Raw material has been flat on the price but as you know its value in US dollars. So, this stuff has been already reflected and it's already on the market.

Ulises Argote:

In 2017, are you planning to do any additional increases or would those at the end of 2016 be a level where you're comfortable at?

Carlos Rojas Mota Velasco:

Well, today we are comfortable with the level we are. That would have to be depending on the exchange rate with the dollar and that—if we have a substantial difference then we

4Q16 Conference Call Script

have to reflect it to the market but today we're definitely comfortable with it, with the prices we have today.

Ulises Argote:

Thank you very much.

Carlos Rojas Mota Velasco:

You're welcome.

Operator:

At this time there is one name remaining on the roster, so if there are any additional questions, please press star, one at this time.

We will go to Pablo Carrillo with BBVA Bancomer.

Pablo Carrillo:

Hi. Thanks for taking my call. I'd like to ask if you can give us a little bit more color on the situation in the United States, particularly in California. With the water levels now rising and they're no longer in a high risk drought level, does that affect any expansion plans for the Company? Thank you.

Mario Romero Orozco:

Hello, Pablo. Good morning. From what we learn in California, the market is still growing and we are also growing by market penetration, so we believe that given the base which is low, and we can have a growth given that the market is growing and also because we are gaining market share, at least in the short term, we will not be affected if the water level changes in the region.

Pablo Carrillo:

Right. Thank you.

Operator:

4Q16 Conference Call Script

We'll pause again for just a moment to see if there are any additional questions. Please press star, one at this time. We'll pause for just a moment.

It does appear that there are no further questions.

Esaú Gallegos:

We want to thank you for your time and your interest in Grupo Rotoplas and hope you join us again next quarter. Until then we'll be sure to provide you with important updates. Thank you again.

Operator:

Thank you very much. That does conclude our conference for today. I'd like to thank everyone for your participation.