

1Q15 Rotoplas Conference Call

Operator

Good morning and welcome to the Grupo Rotoplas first quarter 2015 results conference call.

Please be advised 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, Ms. Nayelli Corro, Grupo Rotoplas' Head of Investor Relations. Please go ahead.

Nayelli Corro, Head of Investor Relations:

Thank you and welcome to our conference call. Yesterday we issued our earnings press release after market close, which is available in the investor relations section of our website at rotoplas.com. I'd like to remind you that certain comments made during the conference call may constitute forward-looking statements regarding future events of the Company's financial performance. These statements are based on management's current assumptions and on the information currently available, from which we do not guarantee the Company's future performance. The timing of certain events and actual results may differ materially from those projected by forward-looking statements due to a number of factors including but not limited to those inherent to our industry, as well as commercial, economic, and other risks and uncertainties.

With us today on the call are Mr. Carlos Rojas, Rotoplas' Chief Executive Officer, and Mr. Mario Romero, the Company's Chief Financial Officer. Mr. Rojas will share some comments on the business environment followed by a review of our results and performance this quarter. Mr. Romero will then share some highlights on our first quarter financial results. We'll then wrap-up our prepared remarks and open the call up for Q&A. With that, I would like to turn the call to Mr. Carlos Rojas. Mr. Rojas, please go ahead.

Carlos Rojas Mota Velasco, CEO:

Thank you. Good morning everyone and thank you for joining us today.

We had a slow start for the year, which we had expected and mentioned on last quarters' earnings call but the situation in Brazil was worse than anticipated, adversely affecting the sales of our integrated water solutions. On the other hand as our results this quarter also demonstrate, Rotoplas' core business continues to do very well with strong growth in all the countries in which we operate. We therefore are confident that this is a temporary situation which does not represent the global or regional potential of the water solutions market or the company itself.

1Q 2015 Transcript

First quarter net sales decreased by 19.8 percent while EBITDA margin this quarter was 9.3 percent, down from 14.4 percent last quarter. This decrease was mainly due to a decrease in Rotoplas' government client sales, as Brazil's economic and political crisis delayed projects and contracts that we had already signed and the Mexican government postponed expenditures to the second half of the year due to mid-year elections.

The challenges we faced this quarter are very clear, and we have a solid grasp on the situation and the steps we can take to alleviate their effects. We are focused on minimizing the impact of the decrease of our Brazil projects on sales and EBITDA of integrated water solutions.

The current global water supply crisis resulting from today's extreme weather conditions and droughts have reinforced the fact that our water solutions are invaluable. For example, the severe drought currently affecting the Sao Paulo State in Brazil has doubled our sales of Individual Solutions compared to the same quarter last year. Therefore, we're confident that demand for our individual and integrated water solutions will continue to increase and that we will continue to successfully capitalize on market opportunities as they present themselves. We plan to achieve this by expanding our product offerings, be innovative in the marketplace, and drive operational efficiencies throughout our organization. Moving forward, our strategic priority is to continue to execute on our strategy in the US. This will reshape our business and further enhance our margin profile.

Along these lines, turning to our US strategy, in January we began operations in the US, where our solutions have been well received by the market. Based on this strong response we will be establishing two more production plants in 2015: one in Texas and the other in Georgia, to cover more of the sun-belt area. Further, our solid financial position due to our recent IPO allows the Company to have a strong position to capture any potential M&A opportunities in the region, some of which are now in our pipeline. We continue to focus on and evaluate new opportunities that may arise.

We will also see potential challenges in the second quarter related to the same government sales in Brazil and Mexico, but we expect an improved second half of the year.

Moreover, due to the slower than anticipated first quarter and considering government sales in Brazil to be at the same low level, we consider sales for full 2015 to be similar to last year. However, we believe our EBITDA will reach around \$1 Billion pesos in line with our original guidance given the strong performance of all other business segments, the cost cutting initiatives and better prices for raw materials for the rest of the year.

1Q 2015 Transcript

Let me now turn the call over to Mario who will review some financial highlights from the quarter

Mario Romero, CFO:

Thank you Carlos. Good morning, everyone.

As Carlos commented, top line decreased 19.8% quarter over quarter, mainly due to reduced demand for our integrated water solutions. The decrease in government spending in Brazil has delayed progress on previously signed contracts and in Mexico government bids for more public contracts were deferred until the second half of the year.

Let me provide you with more color on our solutions segments. Rotoplas' individual water solutions are in high demand for those parts of population struggling with water scarcity and drought-related challenges. Individual solutions increased by 3.2% year on year. Sales from the non-government channels continue to grow at a strong pace and we expect this will continue throughout the rest of the year as extreme drought and water scarcity continues.

First quarter 2014 results included sales of individual solutions to the Brazilian government. In the second half of 2014 we changed our mix from individual solutions to integrated solutions, in order to provide a solution that is more appropriate for the acute water scarcity challenges they are facing in Brazil. Excluding this change in sales mix, individual solutions would have increased by 23% in the first quarter of 2015, driven primarily by demand from Brazil and also by strong performance in other countries in which Rotoplas operates particularly Argentina, Mexico and Peru.

However, our integrated water solution revenues fell 69% year on year due to government spending program delays in Mexico and Brazil affecting our diverse client base in this distribution channel.

We are confident that programs should resume at a faster pace in the second half of the year, due to the Mexican government resuming its integrated water solutions purchases after the mid-year elections and a ramp up of projects already signed with the different Brazilian government entities.

Our cost and expense structure is flexible enough to quickly react to adverse changes in the marketplace. We are therefore relocating some factories within Brazil, to reduce costs and to remain profitable without sacrificing future volume pick-up or new market opportunities.

While financial results in Mexico were in line with our estimates and Brazil fell below our expectations, the other countries Rotoplas serves outperformed our estimates.

Consolidated EBITDA decreased by 48.2%, mainly due to the decrease in sales, and to the increase in the cost of raw materials due to the appreciation of the dollar against the local currencies of countries in which we operate. We anticipate a better 2nd quarter in margins as better resin prices will start offsetting the currency volatility we have experienced during the 1st quarter.

Our Cash position decreased by Ps. 350 million pesos since December 2014, as we used these resources to support working capital needs. Particularly due to an increase in inventories in countries with particularly high growth, and a decrease in accounts payable in Brazil.

To reiterate Carlos's comments, it was a difficult quarter but the issues are clear and we are actively focusing on alleviating their impacts.

We are confident that we will see improvement in the second half of the year due to current business trends in Brazil that could allow speeding up deliveries on already signed backlogged rainwater harvesting solutions, as well as further integrated solutions recovery in Mexico combined with strong individual solutions growth in all Countries.

With that, now we can start with the questions. Operator, please go ahead.

Operator:

And we'll take our first question from Merrill Lynch. Thank you.

Carlos Peyrelongue, Bank of America Merrill Lynch:

Thank you, Carlos and Mario for the call. Two questions: First one related to the guidance you just provided, you mentioned that you expect to do in EBITDA about MXN1 billion, which if I understand correctly with similar sales in last year would be an EBITDA margin of about 15.2%? Can you comment us to how you're going to get that in terms of cost controls or changing mix that will allow that important pick up from a 9% EBITDA margin on the first quarter. And the second question is related to the second half pick up that you mentioned, if you could comment on what are the budgets approved in Brazil and Mexico? How they compare to the budgets approved last year to get a sense of the visibility of the pickup expected in the second half? Thank you.

Carlos Rojas Mota Velasco, CEO:

Thank you, Carlos. And your first question, there is two key things we are executing. One is cost cutting initiative. We are working actively on zero-based budget, that is going to bring us around MXN100 million from last year in our expense reductions and we are seeing now a well environment with raising prices offsetting FX volatility that will give

you around MXN40 million. Just taking what you say, if we do the same sales as in 2014, we did MXN160 million in EBITDA and we held up the cost cutting of 100 million, 40 million in the raising prices that takes you to \$1 million.

I would like to add that we are estimating that the Brazilians government contrast will continuously low for the rest of the year, as they have been this year for the first quarter. And we are growing very fast in the individual solutions in Brazil, Mexico and other countries at a pace of the first quarter we did 23%, particularly Brazil was 100% growth. So we believe that with these, we are going to achieve to have more at least the same sales for last year's. For the second question.

Mario Romero, Chief Financial Officer:

This is Mario. For the second question, there is two parts to it. One, in Brazil, in the government budget for 2015, there is BRL700 million approved. It was approved and finally signed by the President on April 20. It was a 120 day delay from what they normally take the Brazilian government to approve the budget. So money approve is there for the contracts, but we are expecting not to have these volume pick up on already signed contracts, but yet assuming that we keep the same pace, that is about of third of what we've been doing over the last years.

Then second to Mexico, you can see on the first half of 2014, we have integrated water solutions in Mexico and not in the second half. This year is going to be the other way around. We're not having integrate water solutions in the first half, but we are working to have a good second half on integrated water solution in sales to government, especially due to the mid-year elections which government deferred on social programs for the second half.

Carlos Peyrelongue, Bank of America Merrill Lynch:

And Mario, is there any specific budget that was approved for this type of water solutions in Mexico, or is it more local state decision?

Mario Romero, Chief Financial Officer:

There are two. One, on water fountains, there is MXN1.2 billion already approved and putting into a trust, but we are still working on how the rules of implementation is going to work out. So we think that it's going to be coming out in the next months or so. And second on (inaudible) there is some budget we serve for this type of projects.

Carlos Peyrelongue, Bank of America Merrill Lynch:

Okay, thank you.

Mario Romero, Chief Financial Officer:

Additionally and just to be more clear, some states are implementing different programs on the second half of the year.

1Q 2015 Transcript**Carlos Peyrelogue, Bank of America Merrill Lynch:**

Okay, great. Thank you. Thank you, Carlos and Mario.

Carlos Rojas Mota Velasco, CEO:

Thank you, Carlos.

Operator:

And we'll take our next question from Fernando Perez with GBM.

Fernando Perez, GBM:

Hi, good morning. Thank you for the call. I have two questions regarding Brazil. The first one is, I was wondering, if the grand individual solutions enter, we have seen in the last quarter we sustain into a long term. And the second one is one-third in the current spending, well that the government budget has been approved in Brazil.

When do you expect to see the outflow of cash? And if you have any more color regarding the contracts that you have already signed. Thank you.

Carlos Rojas Mota Velasco, CEO:

In the first question, Fernando, this is Carlos. First question is the drought is very severe in Brazil. Brazilians are now cautious about the need of storage in water. So we expect that these at least last according to the studies, five years period, until after Brazilians will have enough water that they don't need to store it and then they will might not be as having as one of their first priority to storage water and would take about five years. In Brazil, our growth, it was a 100% in this quarter against the first quarter last year. Is not only the growth of the market, but we also are gaining important, significant market share in Brazil with our solutions that are better alternative for our consumers. So this is what we're expecting by Brazil.

Mario Romero, Chief Financial Officer:

And then on your second question Fernando, we have signed contracts for the remainder of the year, when we're going to flow, we are not sure about that, but it was approved on April 20 and obviously that takes time to start selling it to the different entities (inaudible). So that is why the world is thinking about Brazil right now is to be very efficient on operating at a lower volume, but if volume speeds up in the second half, we are well prepared to attend it.

Fernando Perez, GBM:

Okay, thank you. And a follow up question. So I was wondering, if the MXN1 billion guidance of EBITDA is contemplating a pickup of spending in Brazil or if you've seen it at current levels?

1Q 2015 Transcript**Carlos Rojas Mota Velasco, CEO:**

It's assuming current levels, Fernando. It's keeping the same pace that we had in the first quarter. The government there -- they believe that they are going to have a better pace in the second half, but in this guidance we are giving is -- assuming as low as it has been in the first quarter.

Fernando Perez, GBM:

Okay, thank you.

Operator:

And we'll take our next question Evelyn Chow with Goldman Sachs.

Evelyn Chow, Goldman Sachs:

Good morning, Carlos, Mario and Nayelli. Thanks for taking my question; I'm (inaudible) on behalf of Chow. I guess my first question; I have for you that was a helpful walk for your MXN1 billion EBITDA. When I think about how you break it down between 100 million from the cost cutting and 40 million from raw materials tail end. What is that imply for the fixed costs absorption that you expect to see on flat sales growth in 2015?

Mario Romero, Chief Financial Officer:

Well, just to separate by countries, we are one, the other countries like Argentina, Peru and Central America are having a very good pick up in margins, due to volume increases. So those that region is going to be out performing very well, the remainder of the year. That will contribute with a better margin throughout the year. Second, as I was mentioning the second half of the year it's considering integrated water solutions in Mexico, which have a very good margin and we didn't have in the second half of 2014. And then on raisings [ph] and effects assuming we just updated our estimates on FX, assuming an environment that's around 15.10 and we are at 3.10. Now we're starting to see the benefits of lower rising prices. As we mentioned in our first call, on the first quarter, we have the double effect, one is steel high raising prices, already they've been coming down, but we have to clean the pipeline, because we were looking at purchases we did in November, December, that impact general survey. And then now we're seeing the real new raising prices that reflects current oil prices levels. So those two are going to help us to be on the 1 billion EBITDA level that we forecast in 2015.

Evelyn Chow, Goldman Sachs:

That's really helpful. And I guess maybe a quick follow-up on the raw materials. Maybe just help me to think of that -- sort of offset that FX have on Brazil, is it purely a translational impact from Brazil being denominated in U.S. dollars and then having to be translated into paces for your COGS?

Mario Romero, Chief Financial Officer:

1Q 2015 Transcript

Yeah, that is correct. And yes, in orders of magnitude, currencies evaluate around 15% on the first quarter compared to first quarter 2014, and Brazil drop was around 4%, because we were seeing at layers coming from November-December.

Evelyn Chow, Goldman Sachs:

Understood. Okay. Great. Thank you for taking my questions.

Mario Romero, Chief Financial Officer:

Thanks, Evelyn.

Operator:

(Operator Instructions) And we'll take our next question from (inaudible).

Unidentified Participant:

Hi, can you tell me how much revenue you expect from those water fountains and from the U.S. this year?

Carlos Rojas Mota Velasco, CEO:

Yeah. This is Carlos. This year we were expecting a significant amount of our budget for the government, we believe that they're going to start with their regulations (inaudible) to implement the resources they have allocated in the droughts [ph] and we have started already doing different places, in different -- we believe -- we are going to be significant until next year will be something important on the sales. U.S. operation again this year we are just starting the introduction of our solutions in the market. They don't have a significant positioned sales for this year as again. This will be important for next year for sure.

Unidentified Participant:

Right. So with Brazil flat for the rest of the year, then the recovery you're looking for isn't a little reliant on the Mexican business, the rainwater harvesting and the outdoor composting in Mexico. Is that fair?

Carlos Rojas Mota Velasco, CEO:

Yes, that was the individual solutions in Brazil, in lot of countries and in Mexico. That is as my displaying, these had a growth of 23%, this quarter against last quarter and we continue, we see that it will continue a strong growth for the rest of the year.

Unidentified Participant

Okay. And then one last question in the individual solutions the revenue growth was strong, but the margin look low on the 12% compared to guidance of 15 to 17, why was that?

1Q 2015 Transcript**Mario Romero, Chief Financial Officer:**

260 basis points, due to the FX effect in Brazil and 295 [ph] basis points, due to lower capacity to absorb our fixed cost, due to the decrease in the whole business volume.

Unidentified Participant

Okay. Thank you.

Operator

And we'll take a follow-up question from Fernando Perez with GBM.

Fernando Perez, GBM:

Thank you. Just a follow up question. So I was wondering, if you could give some guidance regarding the second quarter of this year? Thank you.

Mario Romero, Chief Financial Officer:

Fernando, the second quarter of 2015 will be similar to last year's quarter and slightly better than first quarter of the year.

Fernando Perez, GBM:

Okay, thank you.

Operator

And there are no further questions in the queue. At this time, I'll turn the call back to the presenters.

We have had another question in queue. We'll go to Evelyn Chow with Goldman Sachs.

Evelyn Chow, Goldman Sachs:

Hi, guys. I'm back in queue. Just a really quick follow up. I know, during the IPO process you would expected to use about 20% to 30% of the proceeds in 2015. Is that on track or is it deterioration in the underlying markets maybe putting some of that investment on hold?

Carlos Rojas Mota Velasco, CEO:

Can you repeat the question Evelyn, please.

Evelyn Chow, Goldman Sachs:

Absolutely. I know that in the IPO process you had expected to use about 20% to 30% of the proceeds in 2015, itself. Is that expectations on track or maybe some of the headwinds you're seeing in some of your markets putting that investment on hold?

Carlos Rojas Mota Velasco, CEO:

1Q 2015 Transcript

We are -- as we mentioned expanding the U.S. operation, so a good part of them will go to that expansion. And also we are given the high demand for individual solutions in all countries. We are increasing capacities in all of them.

Evelyn Chow, Goldman Sachs:

Okay, great. Thank you so much.

Operator:

And there are no further questions in the queue at this time. I'll turn the call back to the speakers for any closing remark.

Carlos Rojas Mota Velasco, CEO:

Thank you very much for taking today's call. Have a good day.

Nayelli Corro, Head of Investor Relation:

If you have any more questions, please feel free to contact us at anytime. Thank you.

Operator:

That does concludes today's conference. Thank you for your participation.