

Grupo Rotoplas

2Q18 Conference Call

Operator:

Good morning and welcome to the Grupo Rotoplas Second Quarter 2018 results conference call. Please note that today's call is being recorded and all participants are currently in listen-only mode to prevent background noise. The host will open the floor for questions later.

I will now turn the call over to your host, Ms. Ofelia López Aranda, Grupo Rotoplas' Head of Investor Relations. Please go ahead, Ms. Lopez Aranda.

Ofelia López Aranda:

Thank-you, [operator name].

Good morning everyone. Thank you for joining us today. As you know, we issued our earnings press release yesterday after market close. It can be found in the investor's section of our website. We have also provided slides to supplement our discussion, which can also be found in the investor's section of our website.

Please allow me to remind you that 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.

We are joined today by Mr. Carlos Rojas, Rotoplas' Chairman and Chief Executive Officer, and Mr. Mario Romero, our Chief Financial Officer. We'll begin our call with their remarks and I will then open the floor to your questions. I would now like to turn the call over to Mr. Carlos Rojas. Mr. Rojas, please go ahead.

Carlos Rojas Mota Velasco:

Thank you, Ofelia. Thank you all for joining us today.

As we reported yesterday, we faced a challenging environment this quarter but came out ahead. As a company with a large and growing presence in Latin America, buying a

significant amount of our raw materials in US Dollars, we had to address several issues: significant political uncertainty, slowing economic growth, natural disasters and weak currencies, including the sharp depreciation of the Argentinean Peso against both the US Dollar and the Mexican Peso. Despite these factors, however, we registered double-digit growth in EBITDA and record quarterly sales, we maintained a strong balance sheet and we continued to acquire new businesses in strategic markets, while pushing for organic growth and operating efficiencies, as is laid out in our long-term growth strategy.

In this respect, I would like to highlight the acquisition of IPS, an Argentinean leading water-flow solutions provider, which ideally complements our product portfolio in the region. It was an accretive acquisition and we will be incorporating its results in the third quarter. It is also worth noting that the e-commerce platform we acquired in the United States last year made a significant contribution to our growth this quarter, as did our water-flow solutions product line in Mexico. And, I would like to point out that we have reached over 9,700 purification and water-treatment services in Mexico, which attests to the growth and success of our water-as-a-service strategy.

I believe that our performance in such a challenging environment is a validation of our geographical and product diversification and, most importantly, of our core competitive strengths. It is also very significant that we have achieved this growth while maintaining our positive credit outlook and improving our Bloomberg ESG score, which demonstrates our commitment to sustainability, accountability and a positive social impact.

This performance demonstrates the strength of our business across our main markets, as well as our ability to successfully integrate our acquisitions. As Mexico and the other Latin American economies improve, our company should benefit.

Going forward, we expect that some of the negative factors that were at play this quarter will recede. In Mexico, for example, we are anticipating a more favorable macroeconomic environment following the successful conclusion of the electoral process and the new Administration's commitment to fiscal prudence and continuation of an independent monetary policy. This should help boost consumer confidence and contribute to a more stable currency.

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

Mario Romero Orozco:

Thank you, Carlos. Good morning and thank you for joining us. I will now discuss some of the financial highlights of the second quarter.

As Carlos mentioned, sales grew 9.8% year-over-year this quarter, with a major contribution from the e-commerce platform in the United States and the growth in demand for water-flow solutions in Mexico. EBITDA increased by 14% over the same period thanks to good operational-leverage synergies within the company. In fact, our cash conversion ratio continues to grow stronger as a result of greater fixed-cost and expense absorption due to our growing sales and a more efficient management of our working capital. Nonetheless, during the quarter and in the first semester, our net margins and profit were affected by FX losses and higher net interest expenses due to a net debt position and a weak currency in Argentina.

As Carlos pointed out, we faced a rather challenging environment this quarter in Latin America, due to political uncertainty, natural disasters, slowing economic growth and the sharp depreciation of the Argentinean peso, in addition to overall weak currencies against the US Dollar. Moreover, there were significant interest rate increases that affected consumer spending. Nonetheless, we were able to navigate successfully this difficult environment due to a disciplined cost- and expense-controls through the zero-base budget approach to counter-off this volatility.

In terms of our geographic breakdown, sales in Mexico grew 3.9% during the second quarter, accounting for 65% of our total sales and mainly driven by an increased demand for water-flow solutions from the retail segment. Our operations in Argentina grew significantly as well: 23% in local currency, but the depreciation of the Argentinean Peso continued to offset this growth when reported in Mexican pesos. In fact, if not for the depreciation of the Argentinean Peso, our total consolidated sales would have increased by 15% instead of almost 10% reported. As to the Other Countries category, we continue to seek new opportunities for growth and profitability, introducing new products and services with the appropriate pricing strategies, while closely monitoring the political and economic issues that have affected many of those countries.

With regards to our product mix, sales of individual solutions in the second quarter accounted for 88% of total sales and grew 14.4% year-over-year, boosted by an increase in demand in Mexico and the United States. Integrated solutions, on the other hand, accounted for 12% of total sales and registered a 14.4% decrease year-over-year, which is mostly attributable to the decrease in government-channel sales in Brazil, which is in line with our long-term strategy of de-emphasizing the public-sector channel for the country. It is also worth noting that a larger contribution of the water-as-a-service platform has improved the quality of our EBITDA margins.

These results confirm that we continue to execute successfully into our strategy, good integration results from our acquisitions, while pursuing organic growth through our business strategies of water-as-a-service and water-products. And we have done so while reaffirming our commitment to customer-centricity and to ESG principles, while maintaining a strong balance sheet and a positive debt outlook.

Going forward, we feel confident that we will maintain double-digit growth in Revenues and risk-adjusted EBITDA for the remainder of the year, keep the government-channel sales below 10% and preserve net-debt to EBITDA ratio below 2.0X.

Finally, please take note that starting July 2nd we will start to consolidate the financial, environmental and social results from IPS which is our latest water-flow acquisition in Argentina. The figures and data will appear under the segment Individual Solutions for Argentina.

I would now like to open the floor for your questions. We will begin with the participants in the conference call, followed by our website users. Please proceed, [Operator name].

Ofelia López Aranda

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

Operator:

Thank you. Ladies and gentlemen, if you would like to ask a question, please signal by pressing star, one on your telephone keypad. If you're using a speakerphone, please make sure that your mute function is turned off to allow your signal to reach our equipment. Again, press star, one to ask a question. We'll pause just a moment so that everyone has an opportunity to signal for questions.

We'll hear at this time from Eric Neguelouart of Merrill Lynch.

Eric Neguelouart:

Hello, Carlos, Mario, and Ofelia. Thank you. Could you please give us further details regarding the 77% increase on depreciation year-over-year? Also, with the high volatility in Argentina and your increased exposure to the market, are you seeing any kind of hedge strategy to reduce the FX impacts you've had?

Mario Romero Orozco:

Hi, Eric, and thanks for attending the conference. Regarding your first question, as explaining the press release, we have invested in solid renewal energy for all our factories in Mexico, and we have the chance under Mexican tax law to do an accelerated depreciation on those assets. So, that is part of the explanation on why the depreciation has increased.

On top of that and not significantly, we also made some sales of some assets in Brazil, machinery assets that were no longer in use. So, those to effects explain why depreciation increased quarter-over-quarter when compared to second quarter of 2017.

Regarding the Argentinian market, we have explored different hedging alternatives. Because of the high inflationary environment and the high interest rates, to date taking a hedge is quite expensive, so we have decided to focus more on managing the appropriate pricing strategies and to play well on the inflationary environment so we can counter the volatility affecting Argentina.

Carlos Rojas Mota Velasco:

Eric, this is Carlos. Especially with the environment that Argentina is leading, we believe that strength in our portfolio will be healthy as a natural hedge.

Eric Neguelouart:

Understood. Thank you.

Operator:

We'll go to our next question from Liliana de León of GBM.

Liliana de León:

Hi. Good morning. Thank you. Just a quick follow-up; could you please repeat the main driver behind the D&A (phon) increase? (Inaudible).

Mario Romero Orozco:

Yes. Sure, Liliana. Two things. One, we invested in solar energy panels for our rooftop of the factories, and you can do an accelerated depreciation under Mexican tax law, so that's one thing that increased the depreciation. Second, we sold some machinery assets in Brazil which also accounted into the depreciation. Those are the two main components.

Liliana de León:

Great. Perfect. My second question: could you please give us more color in IPS' integration, I mean, considering the current volatility in FX, what we could expect in terms of revenues or EBITDA for the whole year or maybe for the next year?

Mario Romero Orozco:

I think the perfect way to answer that question is that when we did the press release regarding the acquisition, we indicate what were the multiples that the Company was at quarter four. I think it's fair to say that those multiples were used with an FX exchange rate of 27.5 to 1. So, while we are setting the starting point at that rate, going further, what we believe paying close attention is to pricing which is key not to lose the pass-through effect from the FX to inflation. Therefore, we are seeking to preserve growth into Mexican peso terms. So, those are the two other data points that I can give to you at this point.

Liliana de León:

Great. Perfect.

Operator:

For those on the phone line, if you find that your question has been answered, you may remove yourself from the queue at any time by pressing star, two.

At this time, we do have a question from Santiago. It looks like he removed himself at this point, but as a reminder then, it is star, one if you do have a question; that is star, one for any questions on the phone line. We'll pause another moment.

We do have a question from Rodrigo Verduzco of GBM.

Rodrigo Verduzco:

Hi. Thank you for the call. My question is regarding the expense control. That was one of the highlights for us and we want to congratulate you on that, but could you give us some of your strategy for the expense control and the SG&A as we see. Without depreciation you managed to drop it 12% year-over-year, so could you please give us any color on the cost management or expense management strategies you're implementing?

Carlos Rojas Mota Velasco:

Thanks, Rodrigo, for attending the call and for making such a good question. Back in 2014, Rotoplas started to implement the zero-based budget approach, which basically what we did is every year we started with appreciation (phon) and made people budget their expenses as it was a new company, so they had to really review everything they have in place. So, one is that that's done every month, we review internally (inaudible), what savings can we obtain, and we have a group of 16 people across the Company overseeing daily what expenses can be controlled and which ones can be reused. In that way, what we're trying to achieve is, as you mentioned, a very disciplined approach to SG&A control, and on the other hand, to increase sales. So, the mix creates good operational leverage that we expect to continue on the coming future.

Rodrigo Verduzco:

Perfect. Thank you very much. Congratulations on that again.

Operator:

We do have a follow-up question from Liliana de León of GBM.

Liliana de León:

Yes. Hi. Thank you. Just a quick follow-up regarding cap ex; we saw a 90% increase in the year. It's fair to assume that it's related with integrated solution, particularly Sytesa's plants?

Ofelia López Aranda:

Liliana, could you please repeat the question? I think we lost you at the beginning.

Liliana de León:

Yes. We saw an increase in cap ex for Mexican operation. I mean, it's fair to assume that is allocated into Sytesa's plants?

Mario Romero Orozco:

About 70% of that increase is solar panels. I explained before on the depreciation, and the reminder is on new plants that they are currently being built in Sytesa that will start generating cash flow in the second half of the year.

Liliana de León:

Okay. Perfect. That's very clear.

Operator:

As a reminder, for questions on the phone, it is star, one if you do have a question. That is star, one for questions at this time on the phone.

There are no other questions in the phone queue at this time.

Ofelia López Aranda:

On the webcast, we have also Liliana's question, but I think you have asked the same question on the line. I don't know if you have any follow-ups, Lilly.

Operator:

On the phone line, if there is another question, you can press star, one at this time.

There is no one else in the queue at the moment.

Ofelia López Aranda:

Perfect. Well, thank you, everyone. Thank you very much for your time and your interest. We hope you will join us again next quarter. Until then, we will be sure to provide you with important updates.

Operator:

That does conclude this call. We would like to thank everyone for your participation, and you may now disconnect.