Grupo Rotoplas
3Q17 Conference Call

Operator:

Good morning and welcome to the Grupo Rotoplas third quarter 2017 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 line 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, Alicia.

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

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' 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 line 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. First, let me thank you all for joining us this morning. We appreciate your time and your interest in our Company.

We are very satisfied with our third quarter results, which show a continuing trend of strong sales growth and increasing profitability, with double-digit year-over-year growth in both Sales and EBITDA levels and with a good margin expansion. This is the third consecutive quarter in which our solution's portfolio reconfiguration strategy is proven successful, as we now have a better and more profitable product mix. Furthermore, our cost-control efforts through a zero-based budget management approach continue to have a very positive impact in the profitability of the business overall.

I would also like to highlight the fact that as a result of our portfolio reconfiguration strategy, we have been able to significantly reduce the share of the government channel in our total sales, thus reducing our exposure to the socio-economic and budgetary uncertainty that affected some of our markets. As some of you may recall, the Company decided last year that government-related sales should not represent more than 10% of total sales, in order to reduce volatility in our P&L. This quarter, government channel sales were under 3% of total sales, whereas for the first nine months of the year, they were under 6%.

From a regional perspective, we observed a strong consumer demand this quarter, particularly in Mexico, Argentina and Peru. In Mexico, our organic sales grew by double digits as a result of an increased demand for individual solutions; and the successful integration of Sytesa has already brought about a satisfactory performance in the urban integrated solutions segment, with our water treatment and recycling solutions. Furthermore, we successfully participated in the latest bidding round for the provision of water purifying fountains to the Mexican public-school system.

As we are talking about Mexico, I would like to take a few minutes to talk about the extraordinary solidarity shown by the Mexican people with those affected by the terrible September earthquakes in Mexico City, Morelos, Puebla, Oaxaca and Chiapas. The human and material losses were truly staggering, but even more so was the people's response—including that of our own employees.

After a brief analysis, we decided that the best way to contribute as a company was to activate the Water for Affected Areas Program, or PAZA in Spanish, to help ensure access to drinking water in the hardest-hit locations. To that end, we allocated 25 million pesos to donate storage, purification and treatment solutions through the program in coordination with the Mexican authorities.

There still is a lot of work to be done in the coming months and years to help those affected by the earthquakes, and we reiterate our commitment to continue working hand in hand with the Mexican people in the rebuilding efforts. We must not forget about those in need, particularly in the smaller communities that were very nearly wiped-out.

Going back to the discussion at hand, there was a greater demand for rural integrated solutions in Brazil as well as a greater sales volume of water treatment solutions, which contributed to a better price mix. Furthermore, we continue to implement our strategy of pursuing new projects and clients while applying an effective expense control strategy, which has brought our operations there closer to a financial break-even point.

Moreover, the performance of our Other Countries Division was also satisfactory, as we registered double digit sales growth, largely due to increased sales of water storage and heating solutions, which evidences our brand health and our growing market share in these countries. In fact, the Company has just been included in the Dow Jones Sustainability MILA Pacific Alliance Index, which was launched yesterday to track the performance of the companies with the highest sustainability scores in Chile, Colombia, Mexico and Peru, further recognizing our ESG focus and commitment.

Moving forward, we will continue to leverage our brand, customer service, distribution network and constant innovation to pursue further growth across our different markets and segments, while maintaining our leadership position in the retail segment. We will also continue our diversification strategy, continuing to identify new acquisition opportunities and taking full advantage of the synergies created by the successful integration of our recent ones, which has brought about stability in our P&L and, more importantly, significant growth and better margins.

Finally, we will continue with our refreshed strategy of water-as-a-service, focusing on increasing the breadth and added-value of our services portfolio—which also has the effect of reducing our exposure to fluctuations in prices of raw materials. We will also continue emphasizing the digital acceleration of the company, finding new ways to better serve our customers and, as we have said in the past, we will continue to maintain financial management discipline.

I would now like to turn over the call to Mario, who will guide you through the financial results.

Thank you for listening. I look forward to your questions.

Mario Romero Orozco:

Thank you, Carlos. Good morning everyone. I will now discuss some of the highlights for the third quarter and the first nine months of the year.

As Carlos already pointed out, sales grew 16% year-over-year this quarter and EBITDA grew 79%, extending our positive results trend for the third consecutive quarter. And in the first 9 months of the year, sales are up 29% and EBITDA 55%. Furthermore, I am pleased to report that organic sales growth was 12% and EBITDA organic growth was 57% in the third quarter, reflecting our leadership position in the different market segments in which the company participates.

Our consolidated gross margin increased by 190 basis points year-over-year, mainly due to a greater sales volume of individual solutions in Mexico, which allowed for a greater absorption of fixed-costs.

It is also worth noting that alongside our Sales and EBITDA growth, our margins improved significantly as well. Our operating margin increased by 460 basis points this quarter, as a result of the Company's expense-control strategy and an increased contribution to total sales of urban integrated solutions, reflecting the successful integration of the recent acquisitions. Likewise, our EBITDA margin increased by 590 basis points year-over-year this quarter.

Sales in Mexico grew 18% this quarter, accounting for 66% of our total sales, mainly due to an increase in the demand of individual solutions, evidence of our leadership in the retail segment, and the satisfactory performance of integrated solutions after the successful integration of Sytesa. Organic sales growth was 12%.

Sales in Brazil grew 6% year-over-year and accounted for 6% of total sales, due to a greater demand for rural integrated solutions and a greater sales volume of water treatment solutions, which contributed to a better price mix.

Finally, the Other Countries Division's sales grew 14%, mainly due to the growth in water storage and heating solutions in most of the countries.

With regards to our product mix, sales of individual solutions accounted for 92% of total sales and grew 10% year-over-year due to an increase in demand in Mexico, Argentina and Peru. As a result of greater volume and a better price mix, their EBITDA margin increased by 420 basis points.

Integrated solutions, on the other hand, accounted for 8% of total sales and registered a 228% increase in sales year-over-year. This can be partially attributed to greater sales of urban integrated solutions in Mexico after the acquisition of Sytesa and the reactivation of government purchases of rural integrated solutions in Brazil. The EBITDA margin of integrated solutions grew 2,370 basis points.

With regards to our performance in the first nine months of the year, it should be noted that total sales were $5,032 million Mexican Pesos, a 29% increase year-over-year, which was largely attributable to the strong demand for individual solutions and the successful integration of the acquired businesses. Individual solution sales increased by 20% year-over-year, whereas integrated solutions sales totaled $568 million Mexican Pesos, up from $178 million Mexican Pesos. Organic sales grew 22% and, as was already mentioned, government channel sales were under 6% of total sales.

The gross margin decreased by 240 basis points due to a diminished fixed-cost absorption capacity in some countries and higher depreciation of the urban integrated solutions segment. Meanwhile, the operating margin increased by 130 basis points, reflecting the Company's continued expense-control efforts.

EBITDA grew 55% and the EBITDA margin increased by 270 basis points, partially due to a larger depreciation component.

The net profit margin remained in line with that of the previous year and net earnings per share increased 28% compared to the first nine months of 2016, which is further evidence of the sustained profitability trend over the last three quarters.

Our cash balance at the end of September 2017 increased by $444 million Mexican pesos or 28% compared to the balance at the end of December 2016.

Finally, the Company reached $1,021 million Mexican Pesos of EBITDA LTM.

These results confirm that our current strategy been very successful. Not only have we been able to overcome a very challenging environment in some of our markets during 2015-2016, but we have been able to leverage our core strengths to achieve greater stability and, more importantly, improved margins. Furthermore, with regards to our 2017 guidance, the results of the first nine months of the year allow us to confirm our goal of reaching a double-digit year-over-year growth in both sales and EBITDA.

I would now like to open the line for your questions. We will begin with the participants in the conference call, followed by our website users. Please proceed, Alicia.

Operator:

At this time, if you would like to ask a question, please signal by pressing star, one on your telephone keypad. Again, that is star, one if you have a question at this time.

We'll take our first question from Pablo Ricalde of Bank of America Merrill Lynch.

Pablo Ricalde:

Hi. Good morning. Thanks for taking my question. I have a question on the sequential decline in EBITDA margin you post on the Others region. I don't know if you could provide additional color of what drove that contraction and how should we see that region going forward.

Mario Romero:

Good morning, Pablo, and thanks for joining us for the call. In the Other regions, the margin going forward should improve. As we have explained before, we have been continuing our efforts of penetrating the U.S. market, which has a larger SG&A cost and more stabilized country. Also, the integration costs of Talsar; some of our headcount reductions happened in the quarter in order to optimize the operation. Those are, I would say, the two major components that affected the Other regions margin as opposed to a more normalized operation.

Pablo Ricalde:

Okay. In U.S., are you still reporting a net EBITDA or you're on breakeven operations right now?

Mario Romero:

That is information we do not disclose at the moment, but as explained in the past, when the time comes and the U.S. operation becomes larger, then we'll start to report it on a separate basis.

Pablo Ricalde:

Perfect. Thanks.

Operator:

Once again, that is star, one if you have question at this time, star, one, please. It looks like we have no further questions on the phone lines.

Ofelia López Aranda:

We have a question on the webcast.

Could you please give us more detail on SG&A control, the level of EBITDA in individual solutions sustainable (phon) in the long-term as (inaudible)?

From Liliana de León of GBM.

Mario Romero:

Hello, Liliana. Good morning. Thanks for joining us for the call and for your question. The SG&A control, what we have implemented since three years ago or as of spring break (phon) of zero-based budget, which gave us a lot of visibility and management across all of our expenses, all the different countries where we are. That is the details in how we operate the SG&A control.

Going forward, we believe that some margin expansion should achieve because if we keep good visibility in expenses and the Company grows, there's an operational leverage coming from using the same platform to achieve greater sales, so we believe maybe growth (phon) solutions should benefit margin expansion in the coming years.

Operator:

Again, that is star, one if you have a question on the phone line, star one, please. We have no questions in the queue.

Carlos Rojas Mota Velasco:

Thank you very much for taking up your time. We look forward to see you next quarter.

Operator:

That does conclude our conference for today. We thank you for your participation.