Grupo Rotoplas
1Q21 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.

[DISCLAIMER]

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.

[PRESENTERS]

Today's call will be hosted by Mr. Carlos Rojas Aboumrad, Chief Executive Officer and Mr. Mario Romero, Chief Financial Officer.

I will now turn the call over to Mr. Carlos Rojas.

Carlos Rojas Aboumrad:

Good morning everybody. Thank you for joining us today. As always, I am glad to have the opportunity to discuss with you our latest efforts and results.

[2020 and mission]

As we talked about in our last call, 2020 was an extraordinary challenge but, as it turns out, it was also an extraordinary opportunity to adapt and continue evolving, fulfilling our ultimate purpose: to bring more and better water to our clients and our communities.

We achieve our growth and value creation goals for 2020 and continued with this trend during the first quarter, but most importantly, we also strengthened our ability to address the changing needs of our societies, taking advantage of global trends that continue to change the way we use and perhaps more importantly, the way we protect our scarce water resources.

What do these changes look like, specifically, in the context of the COVID-19 pandemic? We have found that more than 50% of families report an increase in their water bill as a result of their staying at home.

Second, people in Mexico, Central America and United States are investing in improvements to their homes, creating a great opportunity for solutions such as ours that can help reduce water consumption.

The third finding is even more interesting. We found that population is more concerned and conscious about water shortages, water pollution and about the poor quality of water supply.

And finally, and perhaps most importantly, we have discovered that having access to drinking water became a top concern during the pandemic, trailing only behind health, unemployment, and the performance of the economy. It is clear that having access to a clean, dependable water supply is now a top priority for our societies and our customers.

These findings are not surprising, across our markets and throughout the world, the demand for water continues to grow unabated. This causes water stress, which happens where the demand exceeds the supply, and combined with droughts and other natural phenomena, it is driving society's interest for smarter and more sustainable water solutions. The pandemic has been, in a way, a catalyst, an accelerant for changes that were already taking place.

Some companies have adjusted to these changes by adopting better sustainability practices, but we aim to go further. Not only have we deepened our commitment to ESG principles and practices and continue to reduce our own footprint, but we are helping our clients and communities to improve their access to water and the efficiency with which they use it.

We help families, companies, industries, and farmers to reduce their environmental impact. We have adapted and thrived by addressing new consumer habits and global macrotrends but also, crucially, by adopting a more conscious approach, giving equal priority to people, the planet and profitability.

We have been able to do so through our Flow transformational program which is now a key component of our organizational culture.

[Flow evolution]

As some of you may recall, we started Flow in 2019, identifying new avenues for growth and designing the processes that would help us achieve our value-creation goals.

In 2020, the program enabled us to reach these goals and innovate across all areas of our company, contributing very significantly to our growth and EBITDA, enabling the launch of over 23 new solutions and increasing our returns on invested capital above our cost of capital.

This year, Flow is already at the core of the way we operate, as reflected in our five-year plan, driving us to continually reexamine our strategies and operations. As such, it is also at the core of the comprehensive strategy we are implementing, which merges the corporate and sustainability components to create value, drive sustainable growth and give priority to our organizational health.

[Rotoplas Way]

Our organizational culture is embodied in the Rotoplas Way, which we have updated so it is aligned to the evolution of the company. At the center of our day-to-day operations we have a very clear purpose: Improving the quality of life through water solutions in a sustainable fashion. And we do so by focusing on the development of our people, being passionate about our clients, catalyzing innovation, seeking performance multipliers, as well as learning, operating and evolving in an agile fashion. It is who we are, the culture we have built. And it is our path forward.

[Flow Results]

About Flow's evolution, we are happy that this path continues to bring about very positive results. We grew this quarter 26% thanks to our ability to address the new water needs I mentioned earlier, and 17% of sales are linked to flow initiatives.

During the quarter we launched 6 new solutions across the region. In Mexico we introduced the flexible hoses, a new filter, water softeners and electric showers. We also put in the market new storage solutions in Argentina and Perú, as well as a new model of pipes in Perú.

We have allocated $59 million pesos of CAPEX to Flow related projects during the quarter and we managed to fully execute more than 40 initiatives. Also, the cash conversion cycle was optimized by 34 days.

I'm also very glad to share with you that, as part of our 5-year sustainable growth plan, we continued to improve our ROIC, which reached 14.8%.

Our teams are fully committed to this transformation and we will continue to lead our efforts to continuous improvement. During the period more than 750 employees were directly involved in the transformational program.

It is important to note that we have and will continue to maintain our focus on the health and safety of our team. Through their efforts and the loyalty of our customers, we are well underway to achieve our goals for this year.

[Annual Report]

Now, before I turn the call to Mario, I would like to invite you to read our Annual Report, which will be published on April 30th in our website. The report is a key part of our transparency efforts and is elaborated and verified using the highest standards and frameworks. This year, apart from GRI we have aligned to SASB and TCFD recommendations. It is also a great way to better understand how our company is doing its part to help secure a better future for all of us.

Thank you again for your time. I will now let Mario guide you through our quarterly results. We will answer any questions you may have afterwards.

Mario Romero Orozco:

Thank you, Charlie. Good morning. Thank you all for joining today.

[FINANCIAL HIGHLIGHTS]

As you have heard, we registered a very strong first quarter, growing by over 26% due to the increased demand for our products, which was brought about by water stress, droughts, and the new consumption habits. We grew by double digits in all our markets except for Mexico, where we registered an 8% growth in sales due to the contraction in demand for certain services, which I will discuss in further detail in a moment.

As a matter of fact, our net sales and EBITDA are a first quarter record. And even if we account the impact of the pandemic at the end of the first quarter of 2020, sales would have increased close to 20% and EBITDA around 24%. That is, we registered record growth even after considering the atypical nature of March of last year.

[COVID | Operations Status]

About COVID and our operations status, we remain vigilant, and we continue to comply with the strictest safety and hygiene protocols to protect the health of our personnel in our facilities and while working in the field, including periodic testing and regular workplace sanitization measures. Our administrative staff continues to work remotely.

[Financial Highlights P&L]

In terms of our financials, we registered strong demand for our solutions accounting for more than 2.4 billion pesos in revenue.

Our gross margin decreased due to pressure in raw materials prices, partly as a result of the extreme weather conditions in the United States in February, and the increasing demand as the global economy starts to catch up.

However, we retain ample liquidity, are achieving consistent economies of scales and have built a network of local and global suppliers and increased our inventory to ensure an adequate supply. And while this has increased our working capital, it also insures us against future disruptions. In the same vein, we continued to add new personnel to maintain productivity while complying with all sanitation standards and guidelines, strengthening the "SWAT team" I mentioned in our last call.

Our operating margin decreased during the quarter due to expenses associated to the Flow program which amounted to $75 million pesos and the accounting of $6 million pesos related to the implementation of health and safety measures. Nevertheless, it is worth highlighting that our expenses grew at a much slower pace than our sales, evidencing the increasing efficiency we have achieved through Flow and the execution discipline it entails.

Our adjusted EBITDA, after accounting for one-time expenses, grew 31%.

While our net profit contracted year-over-year, it is important to mention that this can be attributed to the fact that in the first quarter of 2020 we recognized a one-time gain when we closed our FX coverage position at a significant profit. Excluding this factor, net profit would have increased 66% year-over-year.

We believe our overall results showcase how our company has evolved and adapted to the new reality of our societies, addressing our customers' needs as they also evolve and adapt to their circumstances across our markets.

We are willing and able to leverage our unique corporate culture, “the Rotoplas Way”, to ensure that we are allies of our clients and communities as they navigate a changing environment. And the execution discipline and innovation generated by Flow have allowed us to do just that.

[Sales per Country | Mexico Argentina, US]

Now, as to our geographic breakdown, sales in Mexico grew 8% during the quarter due to the strong demand for our storage and waterflow products, including the new ones that were added to our portfolio as a result of Flow. The growth in sales of our products compensated for the contraction in the sales of services.

Net quarterly sales in Argentina grew 76%, driven by double digit growth across all three categories: storage, waterflow and improvement, as well as a growing share of the export business, which grew more than 100% and accounts for 5% of total sales. The adjusted EBITDA margin also increased to reach 14.5% as a result of the regularization of operation and an increased sales volume.

Starting this quarter, we will disaggregate our results in the United States, reflecting its increasing importance. Sales in the United States grew 29%, amounting to $256 million pesos, which represent 11% of total Group’s revenue. This growth was driven by the increased consumer confidence resulting from the vaccination roll out, by higher demand of water for agriculture in California and by the migration to smaller communities, which requires further investments in water solutions due to less public infrastructure.

Despite the disruption caused by the blizzards for one week in February in the southern region of the U.S., we increased the number of recurring and new clients, while also expanding the availability of solutions in our digital platforms, which were updated last year. This update, combined with our improvements in delivery logistics and the evolution of our 8 physical stores to service centers, has improved the customer experience and catalyzed growth.

The adjusted EBITDA amounted to $19 million pesos, a 7.5% EBITDA margin as a result of both increased volumes and the average sale ticket, in contrast with the negative EBITDA we recorded in the first quarter of 2020, because of the investments we made to optimize our business

[Sales per Country | and Others]

Sales in Central America increased by double digits during the quarter, partly driven by the reopening of the retail sector and the reactivation of home building in the region. We opened a new plant in Managua, Nicaragua at the end of March. This new plant will supply Costa Rica, Panama and Nicaragua, and will enable us to increase market share and improve our logistics in those countries.

Sales in Peru also increased by double digits, driven by the increased demand for our solutions, including the ones introduced during previous quarters, as well as the increase in consumer spending due to the fact that the government allowed the withdrawal of retirement funds as a pandemic relief measure.

Finally, we continue to focus on strengthening the presence of our water-as-a-service platform in Brazil, including our sales team. We have four water treatment and recycling plants in operation as of the end of March.

[Sales | Products & Services Mix]

Products sales grew 30% driven by the trends we have described and by the initiatives undertaken within the Flow framework. As Charlie mentioned, during the quarter we introduced new solutions, and we continue to increase our salesforce efficiency and our participation in online sales, which have become a key component of the new market landscape.

The strong growth of product sales compensated for the contraction in sales of services, which fell 20% due to two factors: one, and most important, ongoing school closures, which affected the water fountains business; and two, the delay in contract signings for new treatment and recycling plants resulting from the uncertainty that industries and companies are still facing. We remain, however, in a leadership position in both markets and are fully prepared for their eventual recovery. Bebbia, nonetheless, continues to grow solidly increasing 2.3x in number of points of purification.

In terms of our portfolio mix, sales of products during the quarter accounted for 95% of total sales and services for 5%.

Our government sales as a percentage of total sales amounted to less than 4% in the quarter, well below our 10% goal.

[Strong Cash Position]

About our cash position. We optimized our cash conversion cycle by 34 days, and we continue reviewing our terms with related parties through the weekly cash control tower.

Our net debt to EBITDA ratio is 0.8x, well below our 2x ratio policy and a level that we believe is more than adequate to sustain an accelerated growth rate as the economic recovery continues across our markets. It is worth noting that our debt position considers the sustainable bond, which as we have discussed in the previous quarters, netted 4 billion pesos. It also considers a bridge loan in Argentinean pesos for working capital, and a loan in Soles which was granted by the Peruvian government as a measure to reactivate the economy.

[Discipline in Capital Allocation]

During 2020, CAPEX was 3% of total sales, amounting to $71 million.

I would like to note that, as some of you may remember, we have a specialized committee to enhance control and accountability across our businesses. The capital allocation committee ensures not only that every project fulfills our criteria in terms of internal rates of return and net present value, but more importantly, that it is aligned with our comprehensive strategy, including ESG parameters and criteria. Furthermore, as the committee keeps track of the resource allocation and the preliminary results of each project on a quarterly basis, it is possible to adjust in an agile manner.

[ROIC vs Cost of Capital]

Our ROIC stands at 14.8% a 540basis points year-over-year expansion. We remain committed to generating value by continuing to pursue initiatives and actions withing the Flow program, including:

- Greater discipline in capital allocation.
- Increasing production efficiency in our manufacturing processes.
- Maintaining a strict expenditure discipline across all our operations.

[ESG Initiatives & Progress]

Charlie has already discussed the key aspects of our most recent ESG initiatives, but I would like to reiterate the invitation to check out our ESG KPI Dashboard, which is available on our website as well as the Annual Report that we will publish in the coming days.

During this first three months of the year we have concluded the materiality assessment under the methodology proposed by the Global Reporting Initiative and the Sustainability Accounting Standards Board in order to have an approach that contemplates all stakeholders and also a focus on financial risks.

With the results of that materiality analysis, we are updating our Sustainability Strategy so that it is aligned with the 2021-2025 business program.

As you may recall, our 5year plan for sustainable growth, has the goal of doubling sales and increasing profitability, while placing the people, the planet and profit on equal footing. We believe this makes Rotoplas a three-factor story: a growth and a value investment, but also, crucially, a key player in helping to reduce the environmental footprint of our customers and communities and address water stress and supply disruptions. We create value for our investors while upholding the best ESG standards and practices and becoming an ally for those who work towards the common good. Sustainability is at the core of our purpose and our DNA.

[Guidance 2021]

Let me finish up with a heads up around 2021. We anticipate raw materials & energy cost pressures going into the 2Q and 3Q as the global economy shifts into growth mode. However, given our growth in revenue and strong leading brands we continue to expect net sales to increase more than 10%, an Adjusted EBITDA equal to 19% and to keep the Net Debt over Adjusted EBITDA ratio below 2x. We also expect to continue creating value as we maintain our return on invested capital at least 100 basis points above our cost of capital.

[Guidance 2021]

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[Q+A]

Thank you very much for your time. We will now answer any questions you may have.

Mariana:

Thank you for your time, any comment or suggestion please feel free to reach out, we will be more than happy to hear from you.

Have a nice day and see you next quarter.

You may disconnect now.

Probable Q&A

- When will FLOW one off costs end?
- Post pandemic, will we see a slowdown in sales growth, as we are seeing with other pandemic-winners (Netflix, Amazon, etc)?

- Can you give us an estimate of sales and EBITDA contribution of 1) bebbia 2) rieggo by 2023?
- to what extent will rising commodity and resin prices impact gross margin in 2H21?
- As you are already on guidance (EBITDA margin and ROIC) what do you expect to happen next quarters?
- What are you expecting for drinking fountains and treatment plants?
- You mentioned in the Infosplah that Rieggo increased its pipeline, but when are you thinking that Rieggo projects are going to be relevant in terms of sales, 3-5% of the consolidated figures.
- I noticed an important cash burn in the quarter due to the cost of raw materials, could you share your expectations for the remaining months of the year in terms of prices and availability of the main raw materials.
- You mention that water treatment plant contracts have evolved at a slower pace than expected due to COVID19 issues, What actions are you implementing to improve the number of units of the water treatment plants to reach the expectations in the short-term
- Recently several companies have left Argentina, such as Walmart as far as I understand, could you share with us what are the operating strategies that are running the Argentine business unit.
- Could you give us a deeper update on the performance in the US operation, speaking about sales & EBITDA growth for the following years?