

Grupo Rotoplas

1Q23 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.

- [PERFORMANCE REVIEW]

Carlos Rojas Aboumrad:

Good morning, everybody. I appreciate your presence here today.

- [1Q23]

Our first quarter results highlight our strengths, as well as some of the challenges that we are addressing, and the opportunities that exist moving forward. Sales of products continued to grow, as did the sales of services, driven by both bebbia and our water treatment plants businesses, which made a significant recovery during the quarter. Furthermore, we registered growth in local currencies across most of our markets, in spite of economic uncertainty and social and political disruptions in many of them. In fact, we were able to leverage the leadership position of our brands to execute pricing strategies that enabled us to both ensure our competitiveness and protect our margins, in combination with a strict expense discipline.

This growth, which is increasingly diversified both geographically and in terms of business lines, showcases the continued strength of our core business and the potential of our water-as-a-service platform. This is the second consecutive quarter in which our services business continues to expand. The pipeline for water treatment plants in Mexico and Brazil has great outlook, as bookings are regaining traction. Meanwhile bebbia, our drinking water service, continues to grow, and rieggo, our agricultural water solutions business, continues to develop.

However, the growth in sales in local currency during the quarter was offset by the strength of the Mexican peso and the relative weaknesses of other currencies in the region. If we exclude the effects of exchange rates, our growth would have been significantly larger. The “super peso”, as it has been called, also had an impact on our net income. It affected the valuation of our Fx hedging instrument, which is a key component of our risk mitigation strategy, resulting in an increase in our financial expenditures.

We also experienced some operational issues as we upgraded our e-commerce platform in the United States, which together with record levels

of rain and snow, impacted our growth in that country. We have addressed the operational issues, and we still assess a great potential for storage and septic tank solutions in the US.

As impactful as the strength of the Mexican peso was for our overall growth, however, it did not prevent us from continuing to pursue, and achieve, greater profitability. Just like we have discussed in previous calls, our focus on margin improvement is relentless and it shows in the sequential expansion. In fact, this quarter we reached a historical gross margin and a record high EBITDA margin, which were further boosted by the benefit of lower raw material prices.

Likewise, our capital allocation and expense discipline enabled us to continue investing in the development of our new businesses and the modernization of our core one, while still keeping operating expenses in line with sales growth. This drove the increase in our operating income and, more importantly, our return on invested capital continues to surpass our cost of capital.

In short, in spite of the temporary bumps we encountered and that we are addressing decisively, we continue to build the Rotoplas of the future. And the agility and discipline that we have achieved, combined with the leadership position of our brands and the new growth venues we are pursuing, will ensure that we are in the best position to make the most of developing trends such as nearshoring and increasing water stress.

- **[Water opportunities]**

We expect nearshoring, for example, to have an impact in the demand for water and water solutions across Mexico, well beyond the demand specific to the relocated enterprises. Furthermore, it is worth noting that a significant portion of the relocation of production chains is bound to take place in states that already have high levels of water stress, and that S&P has recently assessed that the number of Mexican states with high water stress is expected to double if no mitigation measures are undertaken in the next 30 years. Currently, 11 states are exposed to high water stress, with great impact from droughts on their economic activity and even the daily life of many of its inhabitants. This will increase the need for

investments in water infrastructure, by local and federal authorities, but also by companies and individuals.

In this context, our commitment to empowering our clients and societies to make the best use of water, providing them with smarter and decentralized solutions to help them address their water needs, is more relevant than ever. We remain steadfast in our commitment to people and planet, as we continue to lead and innovate in this crucial industry.

- [ESG]

I am pleased to announce that our company has been recognized as one of the top 8 ESG performers in our industry in the S&P Global Sustainability Yearbook. Furthermore, we are proud to be the only Latin American company included in this category. And we were recently recognized as one of the companies that are committed to the inclusion of people with disabilities in the workforce in Mexico by Éntrale.

In short, while we face some challenges, we are confident in our ability to continue building the Rotoplas of the future.

Thank you for being with us today. I'll now hand over to Mario, and I'm eager to hear any questions or insights you may have.

- [Financials]

Mario Romero Orozco:

Thank you, Charlie, and good morning to everyone.

- [Products and services]

I am pleased to report that our company has achieved positive results in the first quarter of this year. Our efforts to increase profitability while contributing to the wellbeing of our communities and employees have paid off, as reflected in our financial performance. Despite some specific challenges, we remain committed to achieving our 2025 goals.

The Products division's revenues grew only slightly by 1.4% year-over-year (YOY). This slow growth was mainly due to the performance of the Water Flow and Improvement categories in Mexico, Argentina, and Peru. However, despite this, the division's EBITDA showed significant expansion of 52.8% YOY. This indicates that the division was able to control its costs and improve its profitability even though its revenue growth was not very strong.

On the other hand, the Services division's revenues grew impressively by 54.1% YOY. This growth was driven by the strong performance of Bebbia and the Water Treatment and Recycling segment. However, despite this robust revenue growth, the division still reported negative EBITDA. This means that the division's costs were higher than its revenues, leading to an operating loss.

- **[Countries]**

When looking at the company's consolidated revenues, the results were mixed. Mexico outperformed all regions, with a strong increase of 10% YOY. This growth was driven by both the Products and Services divisions, indicating a well-rounded performance. However, Argentina reported a small decline in revenues of 0.8% YOY due to an FX effect, meaning that the weakening of the local currency negatively impacted the company's revenue growth. Finally, the United States reported a significant decline in revenues of 15.9% YOY. This was due to two factors: 1) an operational disruption in its digital platform, and 2) lower demand for storage tanks. Both of these factors negatively impacted the company's revenue growth in the United States.

- **[Highlights]**

Our quarterly operating profit grew 97% year-over-year, reaching \$438 million pesos. Even after accounting for \$86 million pesos in expenses associated with the development of new businesses, operating expenses grew in line with sales, showing operational leverage in our core businesses. Our EBITDA grew 72%, amounting to \$553 million pesos, and the EBITDA margin grew 800 basis points, reaching 20%, a historic high for the company.

In a nutshell, the company's Products division was able to improve its profitability despite slow revenue growth, while the Services division saw strong revenue growth but still struggled with profitability. The company's consolidated revenues were mixed, with some regions performing well and others facing challenges. The United States had a difficult quarter due to operational issues and weaker demand.

- **[CASH POSITION]**

We maintain a strong balance sheet despite the FX effects, which provides a solid financial platform for both pursuing growth and profitability. Our net debt to EBITDA ratio is 1.6x, below our 2x leverage policy. Our cash position still increased quarter over quarter, despite a 12-day increase in our cash conversion cycle due to lower sales in some countries where we operate.

- **[ROIC]**

We remain disciplined and agile with our capital allocation and spending, ensuring that we prioritize the key growth drivers. Our ROIC reached 16% as of the end of March, exceeding our guidance and 410 basis points above our cost of capital.

- **[ESG Initiatives]**

We are committed to upholding and implementing the best ESG principles and practices, which is reflected in our initiatives and efforts. We partnered with the United Nations Development Program to launch “a fluir”, a program focused on providing access to water and sanitation in Mexican municipalities that most lack it. We also implemented initiatives to promote gender inclusion and empower women.

- **[Shareholders' Meeting]**

At our shareholder meeting later today, we will discuss and approve a dividend payment of 50 cents per share and nominate for the first time Mr. Leo Rastogi to the Board of Directors, whose extensive experience in digital, analytics, e-commerce, strategy, and workplace wellbeing will complement our board skills.

- **[Guidance]**

Finally, we have revised our sales growth guidance to greater than or equal to 10% given the strong peso that we are forecasting for the remainder of the year, while maintaining an EBITDA margin between 16% and 17% for now. This margin can be reviewed upwards in the next quarter if conditions prevail, with a net debt to EBITDA ratio equal to or below 2x and a return on invested capital 150 basis-points above our cost of capital to align our expectations with current market conditions.

Thank you for your attention, and we look forward to answering any questions you may have.

[Q&A]

Operator: Thank you, Mario. So, let's start with the Q&A. You can submit a question by pressing the Q&A button in the screen. The first question is from Sofia Martin GBM. Hello, Charly and Mario. Thank you for your time and congratulations on the results. I wanted to understand a little better the decrease in revenue growth guidance. Was this mainly driven by the negative foreign exchange effect that you saw this quarter, or is there another reason?

Carlos Rojas Aboumrad (CEO): It is mainly that Sofia. Thank you very much for joining us. Thank you for the congratulations. But yes, the super peso has affected on revenue in quantity and so affects on that growth. Mario, anything else that you'd like to share.

Mario Romero Orozco (CFO): Well, just to probably complement that, as we disclosed, I think that was the last meeting we said that we set up our plan for 2023 at \$21.50 to the dollar. Now, we believe it's going to be trading on average for the year at \$19.00. That's a 13% effect, which on the revenue side, as Charly explained, affects the growth in Mexican pesos.

In the cost side, it benefits because we are experiencing a lower cost. So that's kind of the effect. And that's one of the reasons when I spoke about the guidance, is that we're going to be reviewing also our EBITDA margin target during the quarter and can be reviewed upwards if conditions prevail.

Operator: The second question is from Carlos Alcaraz, Apalache Research. Hello. Thank you very much for the call and for taking my question. And it's also related to revenue. So, my question related to growth, do you expect this year to be driven by price or volume?

Carlos Rojas Aboumrad (CEO): So, thank you very much for your question, Carlos, and for joining. Revenues we have seen that have been affected greatly by droughts in a positive way in the previous years. And we do see that there is an increasing challenge in terms of drought, particularly in Mexico. In the US, it did change significantly with the amount of precipitation, rain and snow and so it will impact demand in the US even though there's a big opportunity because of lower market shares in the US. But in Mexico we do see a good opportunity for growth still because of a higher water stress. Argentina continues to have important volatility, so there is good opportunity for water solutions. But there are other factors influencing Argentina. The other markets Brazil, Central America, Peru, they continue to have these business tailwinds regarding scarcity. So, I would say that it is going to be highly related to that need for water solutions. On the other hand, in Mexico being the largest market, like we mentioned, revenues are being affected by FX rates. Mario, anything else that you'd like to share.

Mario Romero Orozco (CFO): And just to add on a bit more of color on your question, Carlos. We are reviewing our pricing strategy going forward into the year as we are set up right now. The growth is coming more from volume than pricing, but we might probably speed up growth in the volume side because of all the different benefits we've been experiencing through FX and raw material costs. So that's something we are reviewing, the teams, that the business units are reviewing that info and I think next quarter we can give you more color on how that pricing versus volume end up for the remainder of the year.

Operator: Okay. The coming question is from Martín Lara Miranda Global Research. Good morning and thank you for the call. The gross margin was very strong. Can we expect it to normalize at this level or will it come down?

Carlos Rojas Aboumrad (CEO): Mario would you like to answer?

Mario Romero Orozco (CFO): I think that connects just to the other question, and Martín good morning. Thanks for joining us today. That's exactly what we are just reviewing. You might recall from the previous call that I remember someone made the question around, how's the supply chains, and all the raw materials, things happening and the bottling, and I remember we mentioned that, you know, we were, as it happens, the same way back in April, May 2021. We were experiencing a lot of the bottleneck making of the supply chains, a lot of raw materials coming back pre-pandemic levels. So now we're facing that, is like the demand is there, raw materials are better, prices stay high. So now it's time to review all that and come out with a strategy that maintains us in great market shape, with leading brands and a good profitability. And the reason I said that connects to the previous question is because this quarter we're reviewing what's the best pricing strategy going forward to set up the gross margin as well. So, I think about normalizing gross margins, I think we'll be in a better position to discuss that in the next call. And as I mentioned, again, we also will be reviewing our EBITDA margin target for the year as well.

Operator: We have another question from Carlos Alcaraz. Regarding the digital platform in the US. Do you have another update scheduled during the year?

Carlos Rojas Aboumrad (CEO): Yes. Thank you, Carlos. It is a platform that will continuously be evolving as a digital platform, capabilities improve all the time. And so, our solution should also evolve all the time. We do not have an important development and release for this year. It is just finishing this big launch of a tool that we have been developing for quite some time now. We did face some challenges in that process of going live with that solution, but we expect results to improve in an important way going forward as this solution matures. It is also a solution in which we

have learned tremendously and where we will be leveraging those learnings for the rest of the Company. But we do expect growth in the US in a more stable way going forward in terms of revenues.

Operator: Sofia Martin. She has another question. Could you please give us more color regarding the development of rieggio? Thank you.

Carlos Rojas Aboumrad (CEO): You take that one Mario.

Mario Romero Orozco (CFO): Sure. Well, as all new businesses, takes longer and happens in different ways, the way you develop all businesses. I think all of us would love to happen the same way as when we draft the first business plan. But I think the direction is the right one, rieggio is starting to gain a very attractive traction, pipeline is filling up. And I think the value proposition that we are offering to the market has started to get the likes of our clients in that segment. So, going forward, we believe we'll be posting positive results on real performance. I don't know. Charly, you want to comment anything else around.

Carlos Rojas Aboumrad (CEO): No.

Mario Romero Orozco (CFO): Just maybe that it's harder to develop businesses that the original business plan says and you're an expert in innovation. What's your take on my say?

Carlos Rojas Aboumrad (CEO): Yeah, I agree with you. And, you know. It took us a while to understand how to best leverage Rotoplas' capabilities and strengths in this very new business because it was seemingly a very different market. So yes, agriculture is very different from the rest of the business that we do, but there's tremendous strengths that we have, that we are finding finally how to leverage. And so, we do expect better traction going forward. It's been a stage of tremendous learning and we will start to see that learning materialize in the future. But we're very excited about it.

Operator: The next question. Considering the strength of the Mexican peso. Will you be looking to modify your strategy with respect to currency risk?

Mario Romero Orozco (CFO): No. I think our currency risk strategy has played well for a long term. As you may recall back in 2020 when the pandemic hit. We got a very positive effect on FX and we capitalized on that. 2022 and 2021, it was a good currency risk. 2023 it's the opposite as from 2020. And again, it's like we do currency risk management just to cover the raw materials that are exposed to the US dollar. And that's connected to our financial plan for the year. So, in some ways the risk is a business plan risk for the year. And we don't do any speculative risk. So having said that, we feel that being conservative on the way we manage that risk without taking a speculative risk, it plays better off for all the stakeholders in the long term. And obviously you have these ups and downs like the one I explained back in 2020 and now the one that we're experiencing in 2023.

Carlos Rojas Aboumrad (CEO): So, thank you very much for that, Mario. And just to complement a little bit more and clarify our strategy is to provide stability to our business, leveraging our strength in our balance sheet and in our brand. So, we do not play a strategy to maximize profitability, but for generating more stability, which allows us to focus more on the development of the business. And so, I think it's one that's very conservative and that has served us well. And like Mario said, it will play differently in different cycles. But it's one that we have enjoyed very much in the process of developing the business.

Operator: We have two additional questions from Martín Lara. They are about Mexico and Argentina's operation. What do you expect with respect to Mexico's profitability levels? And the other one is, how do you see the performance of the Argentinian operation during the rest of the year?

Carlos Rojas Aboumrad (CEO): Mario, do you want to take the first one just to complete?

Mario Romero Orozco (CFO): Sure. Thanks, Martín again, for bringing in additional questions. The Mexico margin, again, we are reviewing the pricing strategy given the situation we have explained before. So, we will give you more color going forward. As for Argentina, we just had this past Monday, our regional board meeting where we discussed in profound

around Argentina. You know, the local knowledge says that 2023 is going to be very similar to 2022 in terms of volumes. Obviously, there's the big question around midterm elections happening in August. So, there's like a view that from today to August is going to be very similar to last year. And then from September to December, it's going to be very dependent on what happened on those they call it partial elections. So as of today, we are maintaining the business plan as we have it, the team in Argentina, they just updated their forecast and it's pretty much in line on what we planned by the end of last year. So that is what we have in Argentina. Obviously, Argentina is a special topic that deserves a lot of attention and the local management team and the corporate management team, we are all focused on delivering the best value out of that operation.

Carlos Rojas Aboumrad (CEO): And just one additional comment is that the outlook for increase in exports in Argentina looks very promising, which would create tremendous opportunity for Argentina. So, we hope to see that materialize. But this will be in the context of important volatility, considering the elections that Mario had mentioned.

Operator: Felipe Barragán, BTG Pactual. A quick follow up question. It's about rieggo. Have you all considered inorganic growth for this business?

Carlos Rojas Aboumrad (CEO): Considered inorganic?

Operator: Correct, inorganic growth for the business.

Carlos Rojas Aboumrad (CEO): Mario.

Mario Romero Orozco (CFO): Yes. I think, Felipe, about two calls ago. We explained that we were shifting our inorganic approach as a Company, developing a programmatic M&A strategy to accelerate the services growth profile. rieggo is one of those. So, we have in place a programmatic M&A program within rieggo so we can accelerate the growth profile to capture the opportunity that we are seeing in the Mexican market.

Operator: We have one last question from Sofía Martín GBM. Regarding the new legislation in Brazil that migrates from a state owned to a private

water model. Would that have an implication in your strategy for this country?

Carlos Rojas Aboumrad (CEO): On our strategy. Thank you for the additional questions Sofia. Our strategy in Brazil considers that changing legislation, which is going to really promote the development of the water treatment plant business in that market. It is one strategy of multiple possible strategies that will happen throughout the whole region, but there will be regulation changes that will promote more decentralized solutions one way or another. So, it is one that will affect us in a relevant way, in a positive way, and we're very excited to see that happen. Mario has been studying the topic in more depth. I don't know if you have an additional opinion Mario.

Mario Romero Orozco (CFO): No. I think what we can give to you, Sofia, is our one pager where there's a summary of what marketplace is that changing regulation creating in Brazil which translates into the market opportunity that Charly was explaining. So, I guess Mariana, if you can help us sending that to Sofia so she can have a better understanding on what's really the market opportunity in Brazil?

Operator: Sure. And we have a question from Mauricio Buitrago. Why we didn't update the margin guidance.

Mario Romero Orozco (CFO): I was explaining, we're working hard with the teams to review the pricing strategy going forward. So, once we have that, then we can commit with the market on an updated margin guidance.

Operator: Thank you. And it's also about margins. Felipe Barragan BTG is asking. How has supply evolved and how sustainable do you think the gross margin is?

Mario Romero Orozco (CFO): There's a couple effects on that. One is, remember that our long-term margin target, it's in the neighborhood of 20%. So that's the long-term EBITDA margin we are targeting as a Company. And to achieve that, it mainly needs to happen that services start to gain traction and that learning cause that Charly was talking about start to become profitable as businesses as they grow and are more able

to absorb their fixed costs. So, having said that. We believe that in the long term we will have a sustainable EBITDA margin in the neighborhood of 20% as services pick up. And on the product side we have a very good margin profile, and we are reviewing and again, sorry for coming back to this issue, but it's an important issue. We are reviewing with the new set up of raw materials and FX where it makes sense to balance our volume market share mix. And once we achieve that, then we'll say, well, this is the gross margin that can be sustainable for the long run. And that's something we are reviewing as mentioned. I would love to give you more color on that. But again, I think the trajectory is to hit that 20%-ish EBITDA margin in the long term. And we're just reviewing what's the best way to achieve it.

Operator: We have another question from Felipe Barragan. I think we already talked about the effects, but he's asking: Are you expecting the Mexican peso depreciation or perhaps adding other derivatives on the lower end?

Mario Romero Orozco (CFO): Well. I think those are two questions in one. We will not be adding any more derivatives. As mentioned, we have a derivative program, which is, as Charly mentioned, to bring stability to our business plan for the year. And we don't take any speculative derivatives. So that's the answer for that question and for the other one. I have the view that the Mexican peso will keep strong. You can see the different inflows that we are experiencing as a country from the remesas, from the nearshoring and from the tourism and from others, which is really creating a big flow of dollars into the Mexican economy. So, with all those factors plugged in, I think the Mexican peso will keep strong for the rest of the year if nothing extraordinary happens in the economic or political space.

Operator: And the last question. Michel Galvez Principal Financial. Could you give us some color on the strategy the company is taking in order to take advantage of nearshoring? How is this moving the needle in your strategy?

Carlos Rojas Aboumrad (CEO): Hi, Michel. Thank you very much for joining and for your question. It is something that we look forward to. I think that as new industrial facilities are built, there will be a requirement of our

traditional products, but obviously the use of water for those industries will increase the water stress, which will require more solutions such as rainwater harvesting, water treatment and water reuse. And not only those industrial facilities will be built and generating an increase in water consumption and an increase in water stress, which increases the amount of water solutions that these buildings will need. But also, we will see lots of housing around these industries, which is also a good opportunity for Rotoplas' products and services. So, it will create a big opportunity for us. It is an opportunity, though, that we would have the industrial capabilities to service, and we could react in a very agile way with other capabilities needed to implement, such as engineering, design, field services for implementation. And we would have the balance sheet, the financials to support this growth. And so, we will take a strategy where we will be very proactive in selling these solutions. And so that's going to be the first approach to it. But then in terms of building capabilities, those will be built in a very agile way once these industries are being built and require those solutions. We're actually very good at identifying. We have tremendous strengths at identifying any new buildings in the Mexican market.

Operator: Well, thank you. That was the last question. Would you like to say something else? Mario or Charly?

Carlos Rojas Aboumrad (CEO): I'd just like to thank everyone for joining and for your time and interest and wish you a very good next quarter and see you next time.

Mario Romero Orozco (CFO): Likewise. Thank you very much for joining us this morning. Have a great day. I know you are full of reports and earnings call, so take it easy.

Operator: Well, thank you all for joining us. And if you would like to learn more about our initiatives and efforts in the ESG arena during the past year, we would like to invite you to read the annual report, which is now available in our website. And thank you all. Have a nice day.

Mario Romero Orozco (CFO): Thank you. Bye bye.