

Grupo Rotoplas Second Quarter 2016 Conference Call

2Q16 Rotoplas Conference Call

Operator:

Good morning and welcome to the Grupo Rotoplas second quarter 2016 results conference call.

Please note 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. Ms. Corro Please go ahead.

Nayelli Corro:

Thanks operator, good morning everyone and thanks for joining us today. Yesterday we issued our earnings press release after market close. The release can be found on the IR section of Rotoplas' web site. As usual, we've provided slides to supplement our discussion. These slides can be also accessed on our website under investor information.

Before we start, let me remind everyone that today's discussion contains forward-looking statements based on the environment as we currently see it and as such does include risk and uncertainty. 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.

I'm joined today by Mr. Carlos Rojas, Rotoplas' Chief Executive Officer, and Mr. Mario Romero, Chief Financial Officer. We'll begin our call with prepared comments and then turn to Q&A.

I'd now like to turn the call to Mr. Carlos Rojas. Mr. Rojas, please go ahead.

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Carlos Rojas Mota Velasco:

Thank you, Nayelli. Good morning everyone and thank you for joining our call today.

I would like to begin by giving you some highlights for the first half of the year and then Mario will review the financial performance for the quarter and year to date.

While first semester Net Sales decreased by 6.9% year on year due to weak integrated solutions sales, EBITDA margins continued to strengthen. Sales excluding Brazil again continued to perform very well; revenues from Mexico and Other countries excluding Brazil increased 13.7% year on year.

In Brazil, political and economic conditions affected our sales of water solutions. Brazil for the first half represented 8.7% of our total sales. As stated in our previous calls, we are aware Brazil will not recover in the medium term and will not represent more than 10% of our sales during 2016. Nevertheless, we are working hard to bring the operation to breakeven by the end of this year by running the operation as efficient as possible. On the upside, we have been able to collect 29% of the account receivables from the Brazilian government, benefiting the company's cash flow by 9.7% quarter over quarter.

Turning to Mexico, sales remained flat during the first half of the year. Although, individual solutions sales specially through our retail channel, Rotoplas' main core business, continues growing at a healthy pace. Budget cuts at the federal level affected sales on integrated solutions, excluding water fountains, we expect an improved second half of the year. Excluding sales through the government channel, sales in Mexico increased by 14.7%.

Regarding water purifying fountains, in the current year we have won contracts for the installation of 1,674 units of 6,000 assigned of a program of 16,000 for 2016. Revenue from these contracts will be reflected in Rotoplas' second half results. The opportunity continues, as to date, only 15% of the water fountains have been offered as part of the bidding process for these government contracts, to be completed by 2018 based on a multiyear nationwide program.

Results from other countries again performed well year to date, the strategy for growth has been to strengthen individual solutions. As part of this strategy, we acquired Talsar in Argentina - leader in the production, distribution and sale of water heaters under the Señorial brand. The integration process is going according to plan, we have been able to incorporate more than 45% of the Rotoplas Way while maintaining sales and profitability levels.

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In addition, in the first half of the year we completed the acquisition of a minority stake in the Chilean Advanced Innovation Center (AIC) and an option to increase it in two years to 51%. AIC has developed and patented its high-impact technology for the Plasma Water Sanitation System which purifies 100% of water contaminated. We have big plans for this technology in the years to come; we are working to include plasma into our products, in order to offer a unique competitive advantage to all our clients.

As we announced last week, we signed an agreement to acquire 80% of Soluciones y Tratamiento Ecológico, SA de CV (Sytesa) in Mexico. Sytesa operates more than 470 wastewater and water recycling plants within Mexico solely focused in the commercial segment such as big box stores, shopping centers and office buildings. We are waiting for the resolution of COFECE in Mexico, and following the Board instructions we will publish the details of the transaction once we have all the approvals necessary to close the deal.

At this moment, we can comment you that Sytesa could give short-term synergies to the organic part of Rotoplas' business and could boost current water treatment and water recycling plants as we leverage its proved business model into Rotoplas' business platform.

During the first half of the year, we capitalized on our strong offering and well-earned reputation to strengthen our profitability despite the economic challenges that negatively affected our revenue. Going forward, we still expect a challenging scenario in Brazil that should be mitigated by the expansion in the rest of the countries in which we operate; and as part of our strategy behind integrated solutions, we are transitioning the business to provide water as a service targeting non-government clients. We still have a lot to do on water fountains, water treatment and water recycling plants and the whole water solutions portfolio.

With that, let me turn the call over to Mario to take you through our results. Thank you very much.

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Mario Romero Orozco:

Thank you Carlos and good morning everyone. I'll now take you through the financials for the second quarter and first semester in more detail. We will then turn the call over to the question and answer period.

Net sales remained flat this quarter compared to the same quarter last year. Mexico's sales represented 62% of total sales and remained flat, Other Countries accounted for 30% of sales and grew 77%, while Brazil added 8% to the sales and decreased 61 % year on year.

Individual solutions accounted for 98% of sales and increased 19% compared to the same quarter in 2015, boosted by sales in the retail distribution channel in Mexico and sales increases all across in Other Countries, partly due to Argentina's Talsar acquisition in the second quarter. Integrated solutions contributed only with 2% of sales and decreased 86%, due to the continued effect of Brazil's economic and political crisis and the budget cuts in Mexico that deferred the government programs for integrated solutions to the second half of the year such as Rain Water Harvesting and Outdoor Composting Bathroom.

Sales from the non-government channels continue to grow at a strong pace and we expect this will continue throughout the second half of the year.

Gross margin increased 340 basis points due to an increase in product prices and an improved sales mix. During this quarter, the results did not benefit from lower resin prices as in previous quarters due to a higher FX that offset raw materials cost, the net effect was an erosion of 79 basis points.

We continue to improve our zero based budget practice strategy, which has helped mitigate lower sales volume. As a result, operating expenses decreased 60 basis points.

The EBITDA margin expansion that we saw starting last quarter it continued well into this quarter, as EBITDA improved to 213 million pesos from 155 million in the second quarter of last year; a 37% increase, taking out the acquisition effect, the increase was 18%.

Now looking at our performance for the first six months of 2016, sales decreased 7% year on year, due to the delay of the previously discussed integrated solutions government backed sales.

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In the other hand, individual solutions grew 7% year on year and represented 97% of Group sales, while integrated solutions fell 82% year over year.

Gross profit margin increased 480 basis points, where raw materials accounted for 118 basis points and the remainder from an improved sales mix and an increase in product prices.

Operating expenses for the first semester of the year increased 120 basis points as percentage of sales, due to fix expenses that are not being fully absorbed due to the lower sales volume, as well as expenses associated with ramping up our US operations.

First semester EBITDA increased 29% year, ex-Talsar the increase is 18%, and EBITDA margin increased by 40% percent passing from 10.3% to 14.3%, which represents 400 basis points.

Last twelve months earnings per share increased 41.2% compared to the same period in 2015, demonstrating Rotoplas business model resilience based on diversification in both product and geography, as well on excellent management capabilities.

Finally, free cash flow excluding acquisitions, dividends and stock repurchases was positive for the first half of the year.

With that, I would now like to turn the call over to the question-and-answer session, which will begin with questions from the teleconference followed by questions received via our website. Operator, please go ahead.

Operator:

Thank you. 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 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 for just a moment to allow everyone an opportunity to signal for questions.

We'll take our first question from Adan Rodriguez with GBM.

Adan Rodriguez:

Hello, Carlos and Mario. Thank you for taking my call. Can you give us a little bit more information regarding the amount of water fountain contracts you expect to win in the remainder of the year?

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Carlos Rojas Mota Velasco:

Good morning, Adan. Today, the way we understand is that the client has been trying to know the providers of water fountains that they can serve these contracts. There are already two companies, and we have had a second big one. Today, we have about 28% of the water fountains that they have been assigned. It's difficult to say, but we feel comfortable that our solution that we are building, because then we have to deliver in the school, install and start giving maintenance, our client will start now seeing from the different providers the results of each one of those, and we feel confident that we will continue having more contracts this year. The government has a budget of ~16,000 water fountains for 2016, which they have assigned 6,000, so we are ready to have a good part of that. We hope we can—we feel comfortable that we will get a good amount of them, but it's impossible to say how many.

Adan Rodriguez:

Okay, thank you. That helps. Regarding guidance, do you have any updates, and if so, can you give us a breakdown? Thank you.

Mario Romero Orozco:

Hello Adan, this is Mario. The guidance, we are not moving our guidance. We are expecting still, as mentioned, the water fountains that Carlos explained, and waste water harvesting and other integrated solutions for the second half. So far, things are going good in the retail side, as explained during the conference. Government was been delayed for the first half, but we think we have a good chance to execute in the second half regarding government solutions.

Adan Rodriguez:

Okay, thank you gentlemen. Have a good day.

Carlos Rojas Mota Velasco:

Thank you, Adan.

Operator:

As a reminder, it is star, one to ask a question. Hearing no response, we'll go to our next question, who is Carlos Peyrelongue with Bank of America Mexico.

Carlos Peyrelongue:

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Thank you. Thank you for the call, Carlos and Mario. Two questions, if I may. First one, with regards to the better sales mix that has increased margins, I believe that those sales are in the individual solutions category. Can you comment as to which products have these higher margins that have been growing faster than the rest of the portfolio, please?

The second is related to acquisitions. Can you comment how much you expect the acquisitions to contribute to EBITDA this year? Thank you.

Mario Romero Orozco:

Hello Carlos, this is Mario. Thanks for your question. On the first part, just to remind everyone, we split the business in three categories. One is water storage, the second one is water flow, and the third one is water treatment. We see water treatment and water flow more intense growth than the previous one. The growth is coming from the new categories such as biodigestors, filters, water treatment plants and less from the more mature water storage business.

On the second one, on our last call we mentioned how much we thought Talsar would contribute EBITDA regarding that Talsar was a company that roughly was going to sell about 400 million pesos in 2016 and about 120 million pesos in EBITDA. We incorporated Talsar's results beginning second quarter, so we are going to be capturing around 75% of those results.

Regarding Sytesa, we're still pending, as Carlos mentioned, from COFECE approval. Once we have that, we will know how much we'll be capturing under EBITDA.

Carlos Peyrelongue:

Great, thank you.

Operator:

The next question is from Fernando Perez with Grupo Bursatil Mexicano.

Fernando Perez:

My first question was regarding the integrated solutions margin. It's 50% EBITDA margin, so I was wondering if you could explain the reason of why it's such a large margin. The second question is regarding the accounts receivable from Brazil. I want to know if you have been able to collect any money from Brazil.

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Mario Romero Orozco:

Okay. Well, on the first one, as we've been explaining always, integrated solutions has not only been focused to government sales but also to private sales. We've done some water fountains already, not the ones that we just won in the first half but others sold before that also some system water treatment plants. All of them were sold to the private sector, so that's what you're seeing, is more sales that were very profitable, which is what we've been indicating to the market in the past.

On the second one, on accounts receivable from Brazil, as mentioned in previous calls, this is a federal government warranty accounts receivable. We've been able to collect 30% of those accounts receivable in the first half. We expect to collect about the same in the second half, probably a little less, and the remainder throughout '17.

Fernando Perez:

Thank you, Mario.

Mario Romero Orozco:

Thank you, Fernando.

Operator:

There are no questions remaining in the queue. As a reminder, it is star, one to ask a question.

Mario Romero Orozco:

Here I'm receiving a digital question from **Ulises Argote from Santander**, which we lost in the call. The first question he makes, and I'm going to read them, is can you share with us your expectations in the behavior of your raw material prices for the second half of the year? The second one, is any further reduction in the number of plants on the horizon?

Thanks, Ulises, for your questions. On the first one, we've been seeing pretty stable the raw material prices the second quarter. We expect that the remainder of the year will behave more around the same. The only variable that we are worried about is the FX. There are some macroeconomic events, like Brexit and the US election that could bring some volatility to our currencies.

On the second one, at this point we don't expect any further reduction in the number of plants we have. As you know, we have 23. The last three we opened in the US and the one that we closed in Brazil, so far the business is going to be running in the second half with those 23 plants.

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Probably it's worth mentioning about the news that we released about a month ago about optimizing our logistics and distribution and manufacturing costs in Argentina, therefore closing one of the three plants that we have in that country. The reason is only economically-wise, and we expect some margin expansion coming from that closing. The estimated expansion is very small, but everything at top, it's only 10 basis points.

Operator:

There are no questions in the phone queue.

Nayelli Corro:

So with that, we conclude our call. We would like to thank you for your time and for your interest in Grupo Rotoplas, and we hope you will join us again next quarter. Until then, we'll be sure to provide you with important information and updates. Thank you and goodbye.

Operator:

This concludes today's call. Thank you for your participation. You may now disconnect.

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Forward Looking Statements

This press release may include certain forward-looking statements relating to Grupo Rotoplas S.A.B. de C.V., it relies on considerations of the Grupo Rotoplas S.A.B. de C.V. management which are based on current and known information; however, the forward-looking statements could vary due to facts, circumstances and events beyond the control of Grupo Rotoplas, S.A.B. de C.V.

About the Company

Grupo Rotoplas S.A.B. de C.V. is Latin America's leading provider of individual and integrated water solutions for storing, carrying, and treating water. With more than 35 years' experience in the industry and 24 plants throughout the Americas, Rotoplas has a presence in 12 countries and a portfolio that includes 17 product lines. Grupo Rotoplas has been listed on the Mexican Stock Exchange (BMV) under the ticker "AGUA" since December 2014.