Grupo Rotoplas
2Q23 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. Thank you for taking the time to join us today.

As we have discussed in previous calls, our vision is to create value for our investors by achieving sustainable growth and increasing profitability, while providing the innovation and solutions that our customers need to make the best use of the water available to them. As the environment and industry evolve, we must remain proactive, ensuring that we stay ahead of the curve by showcasing our strategic focus and adaptability, which are essential drivers of our success.

- [2025 Goals | 2Q strategy and results]

We remain firmly committed to our goals for 2025, and our confidence in achieving them remains resolute. Despite operating in a challenging environment, we have shown adaptability and discipline to stay firmly on track. Focusing on growth and profitability drivers within our direct control, we are proactively mitigating the impact of external factors. Our guidance for 2025 includes ambitious targets for annual sales growth, EBITDA margin, net debt-to-EBITDA ratio, and ROIC, reflecting our optimism and belief in our ability to deliver results. With our objectives remaining unchanged, we are firm in our pursuit of sustainable growth and creating lasting value for our investors.

Our results this second quarter are a good example of our capacity to adapt. On the one hand, our growth was negatively impacted by the continuation of the trends we identified in the previous quarter, including a strong Peso as well as economic uncertainty, also we had a high comparative baseline, in contrast to the previous year, which was severely affected by droughts in Mexico as well as other weather conditions in some of our markets. On the other hand, we successfully managed to enhance profitability, while maintaining our market-share in an increasingly competitive environment and continuing to grow our water-as-a-service business.

Consider for example the growth of products and services. Sales of products were influenced by exchange rate effects, resulting in a reduction in growth when measured in Mexican pesos. Additionally, a slowdown in demand and weather conditions like a mild winter in Peru and Argentina or heavy rains in the US, contributed to the impact. After several quarters of record growth across our geographies in both local currencies and pesos, we have encountered a temporary setback.

At the same time, however, sales of services grew for the third consecutive quarter and the EBITDA of this business unit improved significantly, driven by bebbia and our water treatment plant business, both of which continue to showcase the potential of the water-as-a-service platform. And it is worth noting that the bump in product sales growth did not affect our EBITDA nor our EBITDA margin. In fact, during the first half of the year, both our absolute EBITDA and EBITDA margin surpassed our guidance for 2023.

We were able to maintain our market leadership position while adjusting to a rapidly changing market environment across the hemisphere without affecting our operating results in our core business and continuing to pursue new growth avenues. Even after accounting for the effects of exchange rates and variations in demand for products, our expense discipline and agility have enabled us to maintain solid margins, continue the modernization of our product solutions business, keep our net debt to EBITDA ratio below guidance, and, perhaps most importantly, to continue to create economic value for our investors: as of June 2023, our ROIC was 17.6%, 550 basis points above the cost of capital and well above our guidance.

This is not to say that some markets do not present unique challenges that require ongoing attention and resolution. For instance, the macroeconomic stability and the adverse weather conditions in Peru and the United States had a significant negative effect on our growth and profitability. Despite these challenges we remain fully committed to unlocking the potential of our operations there.

Similarly, our long-standing FX coverage strategy had a negative impact on our net profit due to the strength of the Mexican peso. However, it has historically contributed to our bottom line, and as a result, we will continue to implement this strategy moving forward to mitigate currency volatility risks. Our proactive approach to managing such risks demonstrates our dedication to maintaining a robust financial position.

Amidst the pressing challenges of water scarcity and climate change, we persistently uphold our commitment to people, planet, and profit, leading and innovating in this crucial industry, while adhering to the best ESG practices. We are focused on providing the solutions that our customers and societies need, just as we are focused on financial and operational discipline. Our business model has proven to be, time and again, both resilient and agile in challenging environments.

Thank you very much for your time. I will now turn the call to Mario and I look forward to your questions and insights.

- [Financial segment]

Mario Romero Orozco:

Thank you, Charlie. And thank you all for joining us today.

- [P&L]

I'd like to begin reviewing our financial results, but before we delve into that, let's take a moment to recap the strategy we implemented during the second quarter. This strategy was in response to the diverse challenges we faced in the countries where we operate.

Our main priority was to preserve market share and profitability despite the challenging growth environment in the products business. Additionally, we focused on the expansion of our new ventures. The strong peso exchange rate had both positive and negative effects. While it negatively impacted our growth, it also lowered raw material costs, creating new market dynamics that required careful consideration.

Throughout these challenges and unforeseen weather events, we remained committed to a flexible and disciplined approach in allocating capital and managing expenses. This allowed us to implement a competitive pricing strategy, retain our market share, and ensure profitability.

- [Financial Highlights]

Now, going to the financial highlights of the period. Sales decreased 13% in Mexican pesos compared to the second quarter of 2022, with quarterly sales of products declining by 14% and sales of services growing by 33%. The decrease in sales of products is partly due to the reduced demand in some markets. Additionally, the decline can be also attributed to the high comparison point in 2022, caused by an extreme drought and weather conditions in different countries like Mexico and the US, which significantly boosted product sales. On the other hand, the increase in services sales is driven by a record number of subscribers for bebbia and the continuing recovery of the water treatment and recycling plants business.

As in the previous quarter, the effect of the strength of the Mexican peso had a significant impact on our growth, as well on our net income. In fact, we estimate that without this effect, cumulative sales would have contracted 1%. Nevertheless, as Charlie already pointed out, the “super peso” did not hinder our pursuit of greater profitability and we continue to register a significant and sustained improvement in our operating margins during this period as well.

During the semester, there was a 7% reduction in sales of products but also a 43% growth in services, driven by the aforementioned performance of bebbia, the treatment plants business and rieggo.

Our gross margin reached 45% this quarter, an increase of 320 basis points year-over-year, as a result of an agile and competitive pricing strategy, as well as to the reduction in raw material prices. Meanwhile, our expense discipline helped increased our operating profit by 1%.

For the first half of the year, the improvements are even more notable. The gross margin reached 47%, a 520 basis points increase year-over-year. Moreover, the improvement in the gross margin and our expense discipline increased our operating profit by 34%.

Our focus on improving our margins has paid off, driving EBITDA up by 5% this quarter and 30% for the semester, marking a historic record for the company. The quarterly EBITDA margin reached 18%, and 19% for the first half of the year. As Charlie mentioned, this is in line with our guidance, both in terms of absolute EBITDA and EBITDA margin.

Finally, we registered a cumulative net income of $12 million pesos, as we accounted for $520 million pesos loss in our FX coverage instruments.

Now, moving forward to our geographic breakdown.

- [Sales per Country | Mexico, Argentina & US]

Quarterly sales in Mexico decreased 12% and 3% in the first half of the year, mainly as a result of the relative high watermark of 2022 that was already discussed. As mentioned, we executed an agile pricing strategy to protect our market share and profitability in the context of lower raw material costs. Services grew by 31% and 39%, respectively.

In Argentina, quarterly sales more than doubled in local currency, growing 107% driven by both price and volume increases. However, this growth was offset by the depreciation of the Argentine peso and the strength of the Mexican peso. In the first six months of the year, sales grew 104% in local currency, but experienced a 4% decrease when converted to Mexican pesos.

While the storage and improvement categories showed growth in sales volumes, Argentina experienced a similar trend as Peru, where sales of water heaters were impacted by a mild winter during the second quarter.

Sales in the United States decreased by 22%, primarily attributed to a slowdown in demand related to weather conditions and a weaker agricultural sector, especially in the Midwest.

Agro businesses suffered due to sluggish global demand for certain products, localized flooding, soft commodity prices, and the impact of weather conditions.

Additionally, the water tank sales have been significantly affected, particularly in the above-ground water tank segment in states like California, Oregon, and Washington, which were historically major markets.

Moreover, prevailing economic uncertainty and adverse weather conditions have further impacted the sales of septic tanks and the water storage businesses, with higher levels of rain and snow leading to a 19% decrease in sales over the first six months of the year. This reduction in sales volume has also affected the capacity to absorb costs, leading to a weaker EBITDA and delaying the breakeven point for the project.

Nonetheless, we continue to assess the platform and the septic solutions business as a key growth venue in the future.

Quarterly sales in Central America, Brazil and Peru decreased by 21% year-over-year in Mexican pesos, and 11% during the first six months of the year, partly due to the effect of the relative weakness of the local currencies.

Nevertheless, sales in Central America expanded in local currency as a result of our pricing strategy, which was focused on increasing demand for our products. Meanwhile, Acuantia Brazil's water treatment and recycling plants pipeline continues to expand.

On the contrary, Peru is the country that most affects the "Others" category as its sales decreased by double digits, both quarterly and cumulatively, due to a challenging macroeconomic scenario. The available income of families has been significantly impacted by inflation and reduced government support compared to previous years. Furthermore, the sales of water heaters were affected by an unusually warm winter, leading to a decline in demand.

It's worth noting that the cumulative EBITDA margin for this group of countries grew more than 400 basis points year-over-year, reflecting our strict expense control, lower raw materials costs and the economies of scale achieved by Acuantia in Brazil.

Now, moving on to our solutions portfolio breakdown:

- [Sales | Products & Services Mix]

Despite a challenging quarter and first semester, where product sales experienced a 14% and 7% decline, respectively, we achieved a sound EBITDA performance.

Our EBITDA margin expanded both quarterly and cumulatively, surpassing the 20% mark. This achievement demonstrates our capability not only to sustain our market share but also to drive improvements in profitability, even in the face of a challenging macroeconomic environment.

As mentioned earlier, during the quarter, services experienced sales growth of 33%, and 43% for the first six months. Notably, bebbia, achieved record-breaking subscription numbers in just one quarter, boosted by the hot sale in June. Additionally, our water treatment plants continue to gain traction, and rieggo is making steady progress in its development.

The service division remains in an investment phase, despite this, we have managed to reduce its negative contribution to the group's EBITDA.

In terms of our portfolio mix, sales of products were 95% of total sales during the quarter and over the first six months.

Moving on to our cash and debt position:

- [Cash Position]

We maintain a strong balance sheet despite the FX effects, which, as we have discussed in previous calls, provides a solid financial platform to both pursue growth and profitability.

Our net debt to EBITDA ratio is 1.6x, below our 2x leverage policy. It is worth noting that our debt position considers both a short-term loan, which is peso-denominated and obtained in Mexico as well as the sustainable bond AGUA 17-2x, which netted 4 billion pesos.

Our cash conversion cycle increased by 11 days due to the slowdown in volume sales in some of the countries where we operate. Simultaneously, our cash position decreased as a result of Capex, the dividend payments, the stabilization of our working capital and the FX hedge impact.

- [Discipline in Capital Allocation]

CAPEX amounted to 3.3% of sales during the first semester, a 35% decrease year-over-year. Most of these capital expenditures are being directed towards upgrading our core products business, primarily in Mexico. These strategic actions in our core business enable us to pursue new growth opportunities, as we have discussed in the past.

Going forward, we will continue to be disciplined and agile with our capital allocation and spending, ensuring that we prioritize the key growth drivers and increase our profitability.

- [ROIC vs Cost of Capital]

In this vein, we remain steadfast in our commitment to creating sustainable value for our investors. Our ROIC reached 17.6% as of the end of June 2023, a 460 basis points increase from the first half of 2022 and, most importantly, 550 basis points above our cost of capital, exceeding our guidance.

Now, I would like to highlight some noteworthy events and actions in the framework of our sustainability strategy:

- [ESG Initiatives & Progress]

For the sixth consecutive year, our Peruvian team was awarded the Sustainable Management Enterprise Distinction by the Perú Sostenible organization. Also, in that country we undertook two projects to support local public schools and a forestry recovery initiative.

Likewise, in Argentina we partnered with Hábitat para la humanidad to provide storage and treatment solutions to low-income families. And we allied with other companies and associations in the “El Agua en debate” project to increase awareness about water issues.

In June, the month of Pride, our Company embraced a powerful campaign focused on fostering a culture of tolerance, acceptance, and respect.

- [Guidance]

Finally, given the challenging environment, we have made the decision to update our results guidance.

We expect sales to remain at the same level as last year, so we have revised the growth from greater than or equal to 10% to 0%.

On the other hand, through our discipline, we have effectively managed costs and expenses, allowing us to increase the EBITDA margin guidance between 17% to 18%.

The net debt to EBITDA leverage guideline remains below two times, and lastly, we are expecting an ROIC 250 basis points above the cost of capital.

Even as we adapt our approach to reach the goal, our focus on achieving an EBITDA close to 2.2 billion Mexican pesos for the year remains steadfast. While we may experience lower growth, we are strategically emphasizing a higher EBITDA margin. This shift in strategy ensures that our financial objectives stay within reach, despite the change in trajectory.

Thank you for joining us today we can now start the Q&A.

Q&A

Operator: Thank you. You can submit a question by pressing the Q&A button and please include your name and the company. Let's start with Carlos Alcaraz. Apalache Research. "Hello. Thank you very much for taking my questions and congratulations on the results. I would like to ask if you will continue with the price adjustments in the product segment during the second half of the year."

Carlos Rojas Aboumrad (CEO): Carlos, thanks for joining. Good morning. Thank you for your question. And yes, we did have price adjustments in the first half, but we do not foresee any more price adjustments going into the second half. If things remain stable in terms of, FX exchange rate and cost of resins. Which we expect them not to change too much. Mario, anything else that you'd like to ask.

Mario Romero Orozco (CFO): No, I think you say it all. Now I think effects and raw materials have stabilized after a strong decline in the first half of the year. So, we believe that with the measures taken, we remain competitive in all our marketplaces.

Operator: Thank you, guys. I'm going to read the second question from Carlos regarding CapEx. "Will investments in Mexico and Argentina only allow to increase production capacity or would they also lead to an increase in profitability?"

Carlos Rojas Aboumrad (CEO): Thanks again for the second question, Carlos. So, strategies in terms of CapEx are very different in Mexico than Argentina. In Mexico, they do allow to increase both capacity and profitability. The new manufacturing process for the water tank, which was which has been the biggest CapEx investment in Mexico, is one that differentiates us from the competition, allowing us to continue to have a premium against competition in terms of pricing. It has been very well received by customers and so we expect to continue to have this innovation and quality differentiation from competition which allows for these levels of profitability. Again, we're also invested in new manufacturing capabilities, so this increases the capability in terms of volume if needed. For Argentina is very different. Argentina, we do not have as an aggressive CapEx investment strategy. A lot of it is maintenance CapEx. Some assets in Argentina tend to be a little bit older than the average of the company and they need to be maintained. And in terms of what we did do some time ago, which was a new manufacturing plant for water heaters in Argentina, that was to replace a very old manufacturing plant which was acquired by Rotoplas, and it got much more automated, and quality and capability increased very much. And this has been reflected in market shares and also in the sales of volume of heaters in Argentina. We did have a record month recently in June. And so again, a little a little bit of different strategies. Mario. Anything else?

Mario Romero Orozco (CFO): Well, I think just I will add on that, the main CapEx in Mexico is really to differentiate our water tank. So, it can keep up as good product for the next ten years and more than increasing capacity is more about getting better in the marketplace.

Operator: And the last question from Carlos. "Given the economic slowdown in the US economy, will you maintain your investment plan in this region?"

Carlos Rojas Aboumrad (CEO): So, we can consider losses in the US as investments. We do expect the company's profitability to do better in the in the last quarter of the year. But we would like to continue to invest in the US. We think it's a very good opportunity, particularly on Rotoplas being a company that generates a lot of its profit in Mexican pesos and with the strength of the Mexican peso, it would seem like a very good idea, a very good timing and opportunity to invest in the US Mexican pesos that were generated in Mexico being invested in the US. I think that in the very long term that would be a very good return on investment. Also, considering that the main strategy for investing in the US is increasing diversification and sovereign diversification and go and finding a deeper markets for continuous growth for the company. Mario?

Mario Romero Orozco (CFO): Oh, no, I think you get it right. The water sector in the US is growing very well and our long-term thesis does not change because of a slowdown in the US or a slowdown in global plastics revenue. So, we're committed to the region and that's one of our or the market to be successful for us. So, we'll stick to our plan.

Operator: Thank you. Matias Pesqueira from Miranda Partners. His question is, "with the substantial increase in services sales, how does the company plan to leverage this growth momentum? What are your expectations for this segment, and are there any new services offerings in the horizon?"

Carlos Rojas Aboumrad (CEO): Hello, Matias. Thank you for joining and for your time and thank you for your question. So, we're very happy about seeing more traction in sales of services. We do expect this to continue going forward as we have been investing in these businesses very much for the last few years. Investments have been increasing and we do expect to have services become a much more relevant part of our business. We have been investing very much in capabilities as these are very new businesses for Rotoplas. The business models are radically different, and the capabilities needed to serve our customers with services are very different. So, we do expect these investments in capabilities to generate further growth. These investments are not over. They will have to continue to be done in the future. And this will allow us to not only improve our capabilities in services such as bebbia and wastewater treatment, but also in eventually being able to offer more services in our products businesses, such as cleaning our water tanks. We've got tens of millions of water tanks out in the market, and we think we can do much better with service capabilities in those products. One of the biggest opportunities that we have not seen yet on growth, relevant growth from is the septics business in the US. That is a new service. So, this is where we will be focusing in terms of new services going forward but other than that, we won't lose much focus on any other service offerings. So, it's about focusing on the current services, businesses, taking services to some of our core products and focusing on the services business in the US with septics. Mario Do anything that you like to add? You're on mute Mario.

Mario Romero Orozco (CFO): Thank you for joining us this morning, Matias. I was complimenting Charlie. You know the four business that we have, and we have a clear understanding of their potential and growth. Give us a fair runway to a very successful story for Rotoplas. So having said that, we're going to be focused and committed to those four tracks, which will give good results in the medium and long term. These tracks are bebbia, which is the water drinking business. The water treatment and recycling plants. The septic business that Charlie described in the US and the rieggo business that it's focused in the agro-business. So those four elements when we reviewed our ten-year plan, gave us a good growth opportunity. Yesterday we had our board meeting, and we review the plan for ten years and we really like those four businesses the way is set up.

Operator: Thank you. Next. Regina Carrillo from GBM. "Good morning. Congratulations on your EBITDA margin achievement. First question. "Would you give us more color on what to expect in the second half of 2023 in terms of trends by region and by solution? And the second one, congratulations on bebbia's record new users. How many new users do you expect for the rest of the year?"

Carlos Rojas Aboumrad (CEO): Mario, would you care to take the lead on this one?

Mario Romero Orozco (CFO): Well, good morning, Regina. Thanks for joining us this morning. I hope you didn't bring to this the 23 questions that got unanswered last week with the GBM talk. If not, we will need two hours for this morning. But back to your question. You know, you're going to be seeing a very similar Mexico products performance as for the first half. You're going to be seeing a good momentum going into the services business, especially in Mexico. Peru is going to is going to come better off the second half and that's opposed to the first half. The same case as for Central America and Argentina and the US. So, in a nutshell, we're expecting a product's performance in all regions better than the first half and a very good traction in the services segment. So that's the first one. On the second one, Charlie, you want to add to the bebbia's new users or how do you want to work it?

Carlos Rojas Aboumrad (CEO): There's 6000 new users in the second quarter but go ahead.

Mario Romero Orozco (CFO): Well, we are expecting in the second half a net 20,000 users for bebbia and we want to hit the 100,000 mark somewhere in the second half that will make all the Rotoplas people very happy about that that that Mark and we'll keep you posted guys when we hit that one despite it's in the half of the quarter or not.

Carlos Rojas Aboumrad (CEO): Thank you.

Operator: Thank you. Rodrigo Salazar AM Advisors. "Hello. Thank you for the call. Congratulations on the results. And I'm going to read the first question. Mexico product margins seem extremely high versus historical numbers. Is the strategy to maintain margins too this high despite decreasing demand? Has some market share been lost in Mexico?"

Carlos Rojas Aboumrad (CEO): Thank you very much for your question, Rodrigo. And good morning. So just wanted to recall the guidance we've given for 2025. As we mentioned, we believe we will accomplish that guidance which were EBITDA margins close to 20%. That was the guidance that we gave. And so, I think we're in good track to that. This would require for products margins to remain high and that is part of the investments we've made in CapEx. Like Mario mentioned, part of the CapEx is to sustain differentiation and this differentiation offers this the possibility of this high margins, not only just that one initiative like we've talked a lot in the past about that flow program. We've designed and executed on so many initiatives that gives us differentiation and efficiency, which allows us to have these high levels of profitability. Mario, anything else that you'd like to add.

Mario Romero Orozco (CFO): Well, I think we haven't lost market share in Mexico. We are flat or we are maintaining market share. And going forward, as Charlie mentioned, this new technology and this new product differentiation also has a better cost component and more sustainable product because we use less energy. So, profitability, I think. Can be maintain at this level. And remember that if, let's say cost goes up, obviously Rotoplas will lead the price increases. So, we're going to be targeting these profitability level going forward. Sometimes when this happened and the market cleans out, it helps to set up the margins going forward. So having said that, just complimenting Charlie, I think we like what we see going forward in terms of product margins.

Operator: Now, the second question. "Services EBITDA losses seem to have touched rock bottom last year and the trend was improving every quarter. Could you give us some more color why the EBITDA loss and margins were worse this quarter despite sales increasing 30%?"

Mario Romero Orozco (CFO): You want me to jump on that one? Well, that's a very good question and thanks for asking that one, Rodrigo. And this is all US related. If you see a services Mexico. That's where you have the sales increase. And, we have a profitability increase in Mexico or the other way around. We have less losses in Mexico as compared to other quarters. Really, what really makes the difference is the US that it doesn't grows, and it loses more money. So that's where the drag comes for the services as a whole unit.

Operator: Felipe Barragan. BTG Pactual is asking, do you have any updates on the upcoming programmatic M&A?

Carlos Rojas Aboumrad (CEO): Mario, you want to?

Mario Romero Orozco (CFO): Sure. Well, we have a very interesting program that we put together in the last months, as you can remember, about two quarters ago, we started to outline that we're going to be doing a very interesting strategy of programmatic M&A going forward. What is the progress so far? one, we have decided the place where we want to do programmatic M&A, mainly that's Mexico where we want to do it, light touch in the US and in Brazil. Second, all the programmatic is going towards services to accelerate scale. And third, we believe that programmatic M&A can give us anywhere from 4 to 5 additional growth rate for the next five years. So that's kind of the big things I can share with you. We've been discussing with the board for a couple of quarters around this strategy. Yesterday, we have also another round of discussions, but we feel that it is a time to move very specific with some tracks moving there. I don't know, Charlie, if you want to add anything else on.

Operator: Another question from Felipe. "I'm guessing that your primary focus for the US is the e-commerce platform but considering that the septic tank business has the largest TAM from your estimates, I'm curious on the progress of this project. When can we expect some revenues?

Carlos Rojas Aboumrad (CEO): Hello, Felipe. Your appreciation is correct. So, the bigger business with the bigger opportunity is the services with sceptics. And it takes a little bit of time to get into that business, particularly the way we wanted to do it, which was in a differentiated novel approach, two things that we brought to the market were new products with different capabilities, these products needed certification. It's a long process to get the certifications. That's been done. And so that was investment with no revenues for a period. And then the second novel approach was on the way we service customers so that they would have a different experience, which is what we call one stop shop, where customers would have a much better experience by having us with the brand of Acuantia to serve them end to end. And so, for that we've been developing, service capabilities and we've been developing marketing and commercial strategies to get customers, with offering. Both also have traction. There is a need for differentiated solutions. And some of it is because of, you know, traditional solutions contaminating underground water. But while there's an intention since it hasn't been executed at scale, it's new and it takes time for the market to adopt. We are seeing very high growth rates but at very small scale. So, you can't really tell in the results, but it's a business that grows three digits annually. Now where when will it start being relevant. I don't expect it for it to be this year. It'll start showing a little bit more and we can talk more about it next year and it'll really start becoming more relevant a few years from now for that US business. Mario, anything else that you'd like to add.

Mario Romero Orozco (CFO): I think you get it right. Charlie. Nothing to add on this one.

Carlos Rojas Aboumrad (CEO): Thank you.

Operator: Michael Birkel, Zenon. "Thanks for taking my questions and congrats on navigating a difficult quarter well. Could you provide more guidance and outlook on the US business, please? As the growth in past quarters has turned out to be below expectations, probably. How has your competition performed and have you gained market share? Finally, you still expect to reach EBITDA breakeven in 2023 for the US business?"

Carlos Rojas Aboumrad (CEO): Well, Michael. Thanks for joining on your question. You are right. We have been expecting better sales and particularly the biggest opportunity in the US was the slowdown in demand. Demand did slow down very much with the higher precipitation and the slowdown in the economy. We are performing well in market share. We have been developing capabilities to make this business much more digital. So, we've launched lots of different tools and capabilities that have been enabled us to increase our conversions with customers. So just in short, we are below expectations. It is a business that's performing well in terms of market share. New capabilities and big investments were made for those capabilities, and we expect that eventually we'll see the benefits of these investments. Mario.

Mario Romero Orozco (CFO): Well, to add up to your second question. Michael, thanks for joining us this morning. Well, I guess is your afternoon.

On the second question, you know, we have changed it, change our expectations from the US business and now we're expecting a loss of around 15% negative EBITDA. And the reason is, as Charlie explained, it's taking us more time to gain traction into the septic business. And second one is the sluggish demand that we explained throughout the earnings call.

Operator: Thank you. Martin Lara Miranda, Global Research. "When do you expect to generate positive EBITDA in the service business? And what do you see the CapEx level during the rest of the year?"

Carlos Rojas Aboumrad (CEO): Can you take those Mario?

Mario Romero Orozco (CFO): Sure. Okay. Can you. Can you repeat the Mariana?

Operator: Sure. Uh, Martin Lara from Miranda Global Research is asking. "When do you expect to generate positive EBITDA in the service business?" And the other question is, "What do you see in terms of CapEx during the rest of the of the year?"

Mario Romero Orozco (CFO): Sure. I'm sorry I was just distracted for a second. Thanks, Martin, for the question. As we explained in previous calls, when you see the services as a whole unit, we believe that by late 2025 or early 2026, that's when the whole segment will expect to be positive EBITDA. But within it, you have different businesses. For example, water treatment and recycling have a positive EBITDA. Rieggo is expected to achieve positive EBITDA by year end. Bebbia is losing money, the US is losing money. So that's kind of the mix. Obviously, we are focused to bring them up as fast as possible into positive EBITDA territory. But we also understand that we are like in the investment phase to develop the markets. So that's kind of the outlook for the whole business division. But I think it's valid to understand that it's not all the businesses. Some of them are and some of them will be coming in later. And as for the CapEx, we believe that you're going to be seeing a CapEx very similar to the first half of the of the year. So, you'll be ending up somewhere in the neighborhood $400 million of CapEx for 2023.

Operator: Next question also from Michael. “Cumulatively, since 2018, the cash flow from operations has not been high enough to cover both investments and returns to shareholders. To operate sustainably without having to raise further debt going forward, investments have to be limited and or cash flow from operations has to increase. How and with which milestones do you monitor capital allocation into the new businesses? Which criteria do you have to decide when to sell or close new business initiatives if the criteria are not met by a certain time? Thank you."

Carlos Rojas Aboumrad (CEO): Thank you for your question. So let me just start by saying that, since 2018, 2019, we started to increase very much the discipline in terms of value generation for Rotoplas. So, we focused very much on the return on invested capital and that compared to the weighted average cost of capital. So really focusing in generating economic value added and the way we look at new businesses is that we project them into the future with assumptions and we make sure that they're going to be generating value as economic value added. A lot of them require investments for a long period of time, particularly those which are very new capabilities for the company. So, the way we approach it is we set up business cases with very clear initiatives and milestones for those initiatives, deadlines for those initiatives. And we have very clear hypothesis. So, as we are able to validate hypothesis, even if the impact on our financials is negative, we can tell that assumptions are being validated and that the financials or the positive impact in terms of value generation will come. So, if that is the case, we continue with that business. If it's not the case, then we do get out of that business with that discipline. We got out of several businesses in 2019, 2020 and we think we have today only in the portfolio those initiatives that have been proven that will be generating value in the future. Like you mentioned, cash flow does not seem to be enough for the investments in these new businesses, though cash flow is being transitioned from a flow time where we had very high investments into now that those investments are generating benefits, part of the impact in the cash flow is from our FX Hedge on strategy that has impacted us. But that shouldn't be a sustained case. So, we do expect cash flow to improve materially. So, Mario, I don't know if there's anything else that you'd like to add to that.

Mario Romero Orozco (CFO): So, Will probably would like to get a little bit deeper on what you explained and split the things in a period of time. 2020, 2021 and 2022 if you recall, we were adding back the flow expenses to the EBITDA. Those were about $200 million per year. That's about $600 million in total. That we are not having it in 2023. So that's a component of free cash flow coming from products going forward. The other thing, as Charlie explained, this year has been particularly different because of the FX hedge that we took. As you know, we do hedge not to speculate, but to cover the risk of costs of our products. Nobody was expecting a super peso as explaining during the call that has at the level that has created an effect of $520 million in the first half in terms of cash flow that has created an effect of $228 million in the first half of that derivative. So obviously, this is a particular year. So going forward, we don't expect to have a super peso moment Again, I think that's that is a onetime event. And second, you will not have the flow expenses going into the into the cash flow. So those two components help us to feel comfortable that the cash flow coming from products it's enough to fund new businesses without incurring in more debt. We have a ten-year plan and it's as we are, it's a very well financially funded plan. So, we don't anticipate any further debt going forward. And just to finalize and add on the business. As Charlie mentioned, we sell some assets that were not performing. The ROIC is in the neighborhood of 18%. So, we are very focused into creating value to all shareholders. And finally, I will add that we review every single quarter all the initiatives that we do, all the businesses that we do. And if they don't comply, at least with a cost of capital and a spread, which that is spread is determined by the country risk, or adjusted by the country risk, then either sell the asset or stop doing that initiative. So that's the criteria we use. So, when we add up everything together, then we can show you guys how the spread above our cost of capital is performing.

Operator: Thank you, guys. So, it's already the time to leave. But if we have any other questions that we did not answer, we will make sure to get back to you.

Mario Romero Orozco (CFO): Well, we have it. No Mariana? So, I think we can reach out to the different people that get unanswered questions so we can explain to them and also, we can pull those together with the GBM talk that we have last week. And we can approach our investor community and our analyst community and answer all those questions, which I think all of them are very valuable. But we come in first serve basis and sorry for not having enough time to answer all your questions.

Operator: Correct. That's a good idea and we will do that. Thank you very much.

Carlos Rojas Aboumrad (CEO): Thank you, everybody for joining. Pleasure to see you.

Mario Romero Orozco (CFO): Thank you. Have a great rest of the day. Bye.