

Grupo Rotoplas

2Q24 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.

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.

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 the speakers.

Carlos Rojas Aboumrad

Good morning, everyone. Thank you for being with us today to discuss our strategy and the results across our operations. Before we review this quarter's results, I would like to hand the call over to Atlanova, our AI voice and spokesperson on water issues, who will provide an update on the current water situation.

Atlanova, the floor is yours.

Atlanova

Good morning, everyone.

Rotoplas is deeply connected to the environment, especially to the resource that defines the existence on this planet: water. As we analyze current trends, it's evident that the global water crisis continues, with data revealing a path towards critical shortages and scarcity.

The recent heat waves and persistent drought conditions in Mexico have exacerbated the already critical water scarcity. The combination of high temperatures and inadequate rainfall has severely impacted water availability across the country. Currently, 73% of the rainfall evaporates, 21% runs off, and only 6% infiltrates the groundwater.

In Mexico, Rotoplas' operations are crucial, particularly as the country faces acute water scarcity, especially in the northern and central regions. Overexploitation of aquifers and inadequate management practices are key factors affecting both urban and rural communities. As of July 15, the average storage level of the Cutzamala System was 29.1%, a slight increase from previous weeks but still critically low compared to its historical average of 59.9%.

The drought has profoundly impacted agriculture, with 68% of the water in Mexico dedicated to this sector. The reduction in water availability threatens food security and the livelihoods of many communities. For instance, the severe drought conditions have already reduced crop yields by an estimated 30%, affecting farmers' income and increasing food prices.

Additionally, only 17% of the Mexican population has constant access to water. This highlights inefficiencies in water distribution and the urgent need for better infrastructure. The commitment at Rotoplas is to address these challenges through comprehensive water management.

The fight against water scarcity is an urgency humans shouldn't overlook. We are already witnessing the effects of this phenomenon on our operations and communities, as at least 69% of the impact of climate change is expressed through the water cycle. And as we have already shared with you, it is estimated that for every degree Celsius increase in global climate, there is a 20% decrease in the availability of renewable water and change in rainfall patterns.

For example, in the US, as shown in the slide, rainfall has alleviated drought conditions, with improvements observed in 2022, 2023, and 2024. In Peru, as climate change exacerbates temperature variations and increases the frequency and intensity of extreme weather events, people have experienced unusual cold spells this winter.

We have to create resilient water solutions that can withstand the pressures of climate change and population growth.

Thank you for your attention. We look forward to continuing our work together to tackle these challenges and ensure a secure water future for all.

Over to you, Charlie.

Carlos Rojas Aboumrad

Thank you Atlanova. Now after this insightful data let's dive into our quarterly performance.

[Accomplishments + challenges]

This quarter, we have demonstrated our resilience and adaptability amidst a challenging landscape. We have faced unique challenges in each country or region, ranging from climatic issues and increased demand to economic recessions.

In Mexico and Central America, demand for our solutions remains robust, especially during times of water scarcity. Our services platform also performed exceptionally well, with bebbia gaining traction and RSA and rieggo continuing to grow. We are investing in improving our processes to meet demand efficiently, developing robust field services and digital capabilities. This positions us to capture the value our services offer and validates our business strength in water-stress situations. Our participation in the Hot Sale campaign in May with Blue Offers provided additional momentum, boosting sales and reinforcing our commitment to reliable water solutions.

To meet the demand and support growth in this region, we are focusing on:

- Completing the modernization plan for manufacturing technology in storage plants.
- Improving logistics.
- Building the plant in Ixtapaluca to increase production capacity.

In Peru, the climate event that caused severe cold during the winter significantly increased the sales of water heaters. Additionally, we face economic and political instability affecting demand for storage and piping solutions. Our plan is to maintain an efficient fixed cost and expense structure to adjust operations to the size of demand without affecting profitability.

In Brazil, we continue to see positive trends and growth opportunities in developing wastewater treatment plants. We aim to continue business development and secure new contracts by improving our commercial strategy and expanding value offerings, such as consultancy and digital data services.

Moving on to Argentina, the severe economic recession and prolonged devaluation, unprecedented in the last 20 years, have significantly impacted our sales and profitability. Our team remains focused on dealing with strong macroeconomic and political challenges. While it is difficult to provide an

accurate forecast, we remain hopeful that Argentina is on a path toward a more favorable economic environment. The inflation rate is decelerating, and the country has achieved a fiscal surplus, which are positive indicators for potential economic development. Our plan includes keeping our team focused on navigating this volatility, remaining alert to potential improvements in top-line growth and profitability, and closely monitoring developments to adjust our strategies, mitigating risks and capitalizing on opportunities.

In the United States, the improvement in the drought situation has impacted demand; however, we continue to focus on returning to profitability. We have identified opportunities to grow our water business and achieve higher margins through a turnaround plan.

Our mission is more important than ever. We must create resilient water solutions that can withstand the pressures of climate change and population growth.

[ESG]

Before moving on to the second section of the presentation with Mario, I would like to highlight some key ESG milestones. Sustainability is central to our operations, and we have made notable progress in this area during the quarter.

In Mexico, we have initiated the supply of 100% renewable electricity for our León manufacturing plant, which is one of our biggest manufacturing facilities. This is a major step towards a more efficient operation, reducing our carbon footprint and supporting our commitment to sustainable practices.

We have also completed the first phase of development for our online environmental indicators platform, leveraging our strategic agreement with Google Cloud to incorporate artificial intelligence solutions into our functional areas, businesses, and internal processes. This platform will enhance our ability to track and improve our levels of efficiency and environmental performance across all operations.

Additionally, we launched the 2024 edition of the "A Fluir" initiative in collaboration with the United Nations Development Program. This program aims to benefit municipalities with high levels of social deprivation and water stress by donating Rotoplas products.

We also implemented the "Rotogotas de Ayuda" campaign in response to the drought in Mexico, encouraging customers and the community to participate in activities that earn points, which Rotoplas then uses to donate water tanks to the most affected states.

Looking ahead, we are committed to maintaining our market leadership by continuously improving our product offerings and expanding our service

platforms. Our investments in modernizing manufacturing processes and developing digital capabilities are crucial to meeting the growing demand for our solutions and improving our customer experience. We also recognize the importance of being agile and responsive to market changes.

Thank you for your attention, and I look forward to your questions. Now, I will hand it over to Mario.

[Financial Highlights]

Mario Romero Orozco:

Thank you, Charlie, and good morning to everyone joining us today.

AI Mario will assist me with presenting some of the financial results. Mario, please go ahead.

AI Mario:

[P&L - Financial Highlights]

To begin, I would like to mention that our consolidated results were significantly impacted by Argentina. However, it is important to highlight the strong performance in other regions such as Mexico, Central America, Peru, and Brazil. Excluding Argentina, our growth reached 14% for the quarter and 10% for the semester. Additionally, the EBITDA margin would be 19.7% year-to-date.

Regarding our financial highlights, I'd like to focus on our margins as I will discuss our top-line performance by country and business unit later on.

Starting with the Gross Margin, our pricing strategy and increased sales of Tinaco Plus+ significantly boosted the margin. In the quarter, it reached 47%, an improvement of 140 basis points. For the semester, it was 49%, up 210 basis points. This improvement is also due to lower raw material costs during Q1 and manufacturing efficiencies in Mexico.

However, the growth in expenses, coupled with lower sales, has impacted our operating margins. The main factors include a drop in sales in Argentina, increased logistical costs to meet high demand in Mexico and Central America, and expenses related to the development of digital capabilities. As a result, operating income for the second quarter is 29% down year over year, reaching a margin of 10%. Cumulatively, operating income decreased by 16%, representing a margin of 13%. Consequently, the EBITDA margin decreased to 15.1% for the quarter and 17.8% year-to-date.

Finally, our Net Income saw a substantial increase, reaching Ps. 364 million, a 29-fold rise compared to 2023. Last year, we were impacted by nearly Ps. 500 million due to the valuation effects of currency exchange hedges. This year, we adjusted our accounting practices for hedges to record these effects directly in the cost of goods sold, aligning more closely with operational realities.

For better comparability, we have included a table to analyze the impact of the FX hedging on the gross margin. As shown, from January to June 2024, the margin was affected by 50 basis points. Last year, the impact would have been 870 basis points.

[Regional Performance]

Moving on to regional performance, net sales in Mexico surged by 19% in the quarter and 16% for the semester, driven by robust growth in both the product and service sectors. The product segment, especially storage solutions like water tanks and cisterns, as Charly mentioned, saw record sales, bolstered by water supply disruptions mainly in the central region of the country, as well as by the Hot Sale campaign in May, which we called "Ofertas Azules." The services platform also grew rapidly, with significant growth in bebbia, RSA, and Riegg. EBITDA margins contracted primarily due to increased operating expenses.

In Argentina, net sales decreased by 37% in Mexican pesos for the quarter but grew by 145% in local currency due to currency devaluation and inflation. Cumulatively, net sales decreased by 34% in Mexican pesos and grew by 176% in Argentine pesos. This impact is due to the economic recession that has affected sales volumes and pricing. Lower sales and dollarized expenses negatively impacted margins.

In the United States, net sales decreased by 11% in Q2 and by 15% cumulatively, primarily due to an easing of the drought situation and heightened competition. The septic tank business refocused to optimize services by geography, currently providing full service only in Texas. Cost containment strategies helped reduce negative EBITDA during the quarter and for the semester. While the EBITDA margin remains negative, it is progressively improving towards breakeven.

Other countries, saw net sales grow by 15% in Q2 and by 3% for the semester, driven by strong performance in Central America and a recovery in Peru during the second quarter. Despite a challenging environment in Peru, sales increased due to higher demand for water heaters during a severe winter. Central America saw growth across all categories, with record storage sales volumes. In Brazil, water treatment and recycling plant projects continue to progress, with significant contract closures. The EBITDA margins decreased due to increased logistics expenses in Central America and construction costs in Brazil.

[Segment Performance]

Regarding the performance of our product and service revenues, services now represent 8% of our total sales.

Within the services segment, we have seen remarkable progress;

- Bebbia has significantly expanded its reach, now serving over 120,000 users, reflecting our successful penetration and growth in the consumer water solutions market.
- Rieggo, taking into account the recent acquisitions, has successfully installed innovative irrigation solutions across more than 55,000 hectares, showcasing our commitment to enhancing agricultural efficiency.
- RSA has increased its scale and reach, while Acuantia Brasil shows promising growth prospects due to ongoing processes with a high likelihood of closing.

Furthermore, our strategic acquisitions have strengthened our market presence, allowing us to create synergies that drive our growth. Additionally, our services sector is experiencing improved EBITDA as it scales up and benefits from additive M&A transactions.

[Cash Position]

Our financial stability is supported by a robust balance sheet with a net debt to EBITDA ratio of 1.8x, well below our policy target of 2.0x.

The cash position includes significant disbursements during the semester, such as \$545 million in working capital, \$287 million in financial expenses, \$243 million in dividend payments, \$236 million in capital expenditures, and \$178 million in mergers and acquisitions.

Our total debt stands at Ps. 4.3 billion, structured between short-term and long-term liabilities to optimize financial flexibility.

Short-term debt amounts to Ps. 322 million, primarily used for working capital to efficiently manage day-to-day operations. Long-term debt totals Ps. 4 billion, composed of the fixed-rate sustainable bond. The blended cost of debt is 9.05%.

Additionally, we maintain a tight focus on working capital management. Our interest coverage ratio remains healthy, consistently above 8 times, reflecting our strong ability to meet interest obligations.

[Capital Allocation]

During the semester, our capital investments represented 4% of sales, reflecting a significant increase of 24% compared to the same period last year. Notably, 95% of these investments were allocated in Mexico.

We continue to roll out the SMART program to the remaining plants to achieve more efficient and sustainable production of storage solutions like the Tinaco Plus. Additionally, we are investing in the construction of the new plant in Ixtapaluca. Furthermore, we allocated Ps. 53 million to Bebbia and Ps. 22 million to treatment plants.

[Return on Invested Capital (ROIC)]

Our Return on Invested Capital reached 12.7% due to the weak results in Argentina, as well as a higher effective tax rate in Mexico and Central America. However, it's important to note that this figure is still more than 100 basis points above our cost of capital.

[Guidance and Outlook]

Finally, we will update our guidance due to the acute economic recession in Argentina. Our current expectations are:

- Growth between flat and 5%
- An EBITDA margin between 17% and 18%
- Leverage remaining below 2 times
- An estimated ROIC equal or above the cost of capital

I want to emphasize that these estimates will remain valid as long as the situation in Argentina does not deteriorate further and macroeconomic variables in other regions remain stable.

[Closing Remarks]

We appreciate your time and interest. In closing, I want to reiterate our commitment to leveraging our talent and resources to achieve growth and profitability while enhancing the quality of life for many people across the continent.

We can now begin the Q&A session.