Grupo Rotoplas

3Q20 Conference Call

Operator:

Good morning and welcome to Grupo Rotoplas Third Quarter 2020 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 Mr. Carlos Rojas.

Carlos Rojas Aboumrad:

Good morning everybody. Thank you for joining us today.

As you all know, our societies continue to navigate a complex environment and we all have had to continue adjusting. However, as I mentioned in our previous call, the situation has reassured us of our purpose, and we are thankful for the opportunity to continue to serve and help our customers and our communities. Throughout these times we have stayed the course and remained focused on the well-being of our team members and our clients while creating value for our shareholders through innovation and even greater efficiency and a strict cash flow discipline.

As a company with the mission of providing more and better water, we were uniquely positioned to make a difference for our clients while pursuing our transformation program, Flow. We have seized that opportunity, achieving growth throughout our markets, and implementing new initiatives that strengthen and streamline our operations, aligning our company with both market trends and the new consumption habits brought about by the pandemic. We remain on track towards our value-creation goals while strengthening our commitment to ESG principles and best practices.

During the quarter, operational restrictions were less strict than during the second quarter. Our plants and working spaces follow health and safety protocols that are very strict and beyond local regulations. Nevertheless, we experienced some restrictions in our Argentinian improvement manufacturing facility as well as in some distribution centers in Central America.

Despite these impediments, during the third quarter we registered double digit growth in both sales and EBITDA. We reached a quarterly sales record as also quarterly EBITDA record.

We grew double digit in all of our markets except for Argentina, which remained stable but also achieved to double in EBITDA, as Mario will discuss in further detail in a moment.

Also, in Brazil after the divestment of the products business in May, we started to operate the first water treatment and recycling plants during the quarter.

We achieved Group's growth through the strength of our product and services portfolio, which was augmented with the introduction of new products and the optimization of our sales force, both of which were a direct result of Flow.

In fact, in the first nine months of the year, Flow has contributed 21% of our EBITDA, so $2 out of every $10 pesos of Adjusted EBITDA come from initiatives that were designed as part of Flow.

Flow has generated over 950 initiatives of which more than 45% are already contributing to sales or EBITDA and involve over 25% of our workforce.

The allocation of capital expenses to Flow initiatives amounts to $132 million, 64% of total CapEx. Also, we have registered $ 96 million of Flow execution expenses, including the implementation of initiatives, fees paid to the consulting firm and the human talent restructuring and realignment.

It is worth mentioning that the transformation has achieved a 9.8% ROIC, representing the tightest gap between ROIC and WACC for the last 17 quarters. Additionally, it has helped us to accomplish greater discipline in cash flow management, optimizing the cash conversion cycle by 23 days.

Likewise, Flow has allowed us to respond nimbly and with strict discipline to a challenging environment, creating and executing initiatives that strengthen all aspects of our business.

Another good example of the results brought about by Flow is the recent launch of our joint venture with RRG Solutions México, *Rieggo*, which will focus on technologically disruptive water solutions for the agricultural sector.

This is a significant growth opportunity for our company, taking full advantage of the synergies we have with RRG to address the need for sustainable water solutions that will allow producers to increase quality and yields in the context of increasing water scarcity.

We are entering a water-intensive market, and we are doing so while reaffirming our commitment to sustainability and innovation.

Flow's evolution discipline is now engrained in the Rotoplas Way and is cemented by the appointment of our new Chief Transformation Officer, who will be in charge of ensuring the continuity and rhythm of our ongoing transformation.

Flow has increased our resilience and provides us with a pathway to ensuring that we reach our goal of creating value by generating a greater return on capital than our WACC, to which we are now closer than ever, as Mario will show you in further detail. Furthermore, it has also enabled us to do so in alignment with our commitment to ESG principles and to innovation.

I cannot stress enough the importance of these innovations. As you can see in the slide where we took Mexico as an example, the country has a high level of general water risk as it consumes an exceedingly high percentage of the water available, according to the World Resources Institute. And almost half of the country is classified as having an extremely high risk.

As we address the urgent needs of the pandemic, we must also focus on the longer-term need for innovative and sustainable water solutions in the hemisphere.

Rotoplas continues to grow as it has been able to provide these solutions for its customers in order to increase their resiliency against this life-threatening matter.

Through our transformation program, we will ensure that we will continue to be able to offer our solutions and will remain the leaders of this effort.

I will now turn the call to Mario so that he can go into further detail about the key financial results of the quarter. Thank you for your time. I look forward to your questions.

Mario Romero Orozco:

Thank you, Charlie. Good morning to you all. Thank you again for joining us today.

As Charlie pointed out, our record quarterly results show that we have been successful in addressing the needs of our customers and our communities in these complex and uncertain times while continuing to advance towards our goal of creating value for our shareholders.

As we mentioned in our previous call, we believe that providing more and better water is not only our reason for being but is also a sound business vision. We are, as he said, aware of the need to address the opportunities and challenges created by the pandemic as well as those of the future. We continue to strive to best serve our customers and communities while generating profitability and adjusting to the changing landscape of the pandemic.

We are convinced that we participate in an industry with enormous growth potential, that we have a robust products and services portfolio, and most importantly, we are going to achieve our value creation goals as Flow is getting better traction on a daily basis.

While we still experienced some operating restrictions in Argentina and in Central America, our operations in Mexico, Peru and the United States were continuous throughout the quarter and, by September, all operations were continuous. This has entailed of course a significant effort to ensure that we comply with the strictest safety and hygiene protocols to protect the health of our personnel in our facilities and while working in the field. It is also worth noting that our administrative staff continues to work remotely.

As Charlie said, we remain focused on the well-being of our team members and our clients as well as maintaining a strong cashflow discipline, while continuing to advance in Flow. And this focus has brought about strong results for us this quarter.

We reported record sales in the history of Rotoplas which increased 18%, and the adjusted EBITDA grew 14% year-over-year. As Charlie pointed out, this growth is the result of our ability to address the increased need of water for hygiene and wellness purposes as well as the introduction of new products and the optimization of our sales force.

With this growth we anticipate an increase in market share in all countries and categories, except from improvement in Argentina due to the operating restrictions related to the change to a new manufacturing plant.

I would like to point out that we maintain strong brands and leadership across the region.

It is also worth noting that our government sales as a percentage of total sales amounted to 4.6%, well below our 10% threshold.

Moving forward on the P&L, our operating margin decreased by 100 basis points due to greater production costs related to the hiring of additional personnel and the payment of overtime to comply with health and safety protocols in response to COVID-19.

Our operating income decreased 11% year-over-year due to the expenses associated with the implementation of health and safety measures, which amounted to $7 million pesos, $4 million in donations and the accounting of $75 million pesos expenses associated to the execution of Flow.

Without these non-recurring expenses, the margin would have been 15.3% and operating expenses would have grown 14.1%, which is below the increase in sales.

After financing expenses related to the payment of interest on the sustainable bond, foreign exchange losses from a long position in dollars to cover costs and expenses in that currency according to the budget, and loss from monetary position in Argentina, our net profit before discontinued operations totaled $41 million.

We have also maintained our cashflow discipline, optimizing our cash conversion cycle by 23 days. And most importantly for our value-creation goal, our ROIC reached 9.8%, an increase of 50 basis points year-over-year and a 193 basis points increase since the beginning of Flow. We are now, as Charlie mentioned, much closer to our objective of having a return greater than our cost of capital.

At this point I would like to briefly recap Flow's main features for those who may not be familiar with it. Flow is a transformational effort aimed at ensuring the company's sustainable growth, its profitability, and the creation of value for our shareholders.

The immediate objective was defined as "achieving an ROIC greater than the cost of capital in 18 months".

Working with a leading global consulting company, the implementation of Flow has enabled us to focus on three main pillars: Profitability of the current portfolio, growth initiatives and execution, and organizational culture and health.

This has translated into initiatives such as the divestment of underperforming assets, the introduction of new products tailored to the needs of each of our markets, and others concerned with increased operating efficiency and capital allocation.

In this vein, Flow has been crucial to the results we have achieved so far, and we expect it to make an even greater contribution in the future.

Let us now continue with our quarterly results.

Sales in Mexico grew 14% during the third quarter and 9% during the first nine months of the year, due to the strong demand for our storage and waterflow products, including the new ones that were added to our portfolio as a result of Flow initiatives.

We also benefitted from the easement of the lockdown restrictions and a higher dynamism in the construction sector, although there still is little correlation between our sales and the sector's overall trends, attesting to the diversification of our customer base.

As to our water-as-a-service platform in Mexico, our drinking water service, *bebbia*, grew 73%, registering record sales and a higher average ticket. Drinking water fountains business grew soundly recording revenues from contracts that were signed in previous quarters.

The uncertain environment had a negative impact on investment and, as a consequence, on the demand for water treatment plants in Mexico.
Also, the number of plants that have gone from the integral model to only operation and maintenance could not be compensated with the startup of new ones. Despite having a robust booking, the mobility restrictions caused by COVID-19 have delayed projects execution.

The quarterly adjusted EBITDA decreased 14% year-over-year due to expenses related to our adaptation to the new normal and the investment to grow and expand the purification platform.

Net Sales in Argentina grew 29% in local currency, but they remain at the same level of last year's in Mexican pesos as a result of the depreciation of the Argentinean Peso.

Furthermore, we estimate that the operating restrictions I mentioned earlier reduced our sales by $35 million pesos during the quarter. Nevertheless, our pricing strategy, strict expense discipline and growth in storage and water flow volumes helped to double the quarterly EBITDA.

Sales in the United States continue to grow at a double digit rate driven by the migration to online consumption, the "America went home improvement" trend, and the increase in water storage needs due to the time families spend at home because of the confinement.

During the quarter we carried out an optimization of the e-commerce platform which has enabled us to triple our sales conversion rate. We also opened our 8th physical store in Fort Worth, Texas.

Sales in Central America also increased by double digits, in spite of the disruptions to our operations, thanks to the optimization of our sales force productivity and the incorporation of new products to our portfolio. Greater synergy between the countries of the region have boosted sales and profitability.

Peru increased its sales by double digits. As anticipated, the recovery trend that followed the June reopening, combined with the introduction of new sales channels and new storage and waterflow products, as well as the synergies with our Argentinean operations, contributed significantly to this result.

Finally, after the divestment of our product unit in Brazil in May, we continue to focus on strengthening the presence of our water-as-a-service platform in that key market through our treatment and recycling plants, of which three are now in operation, three under construction, and one in the last stage of contract signing.

In terms of our portfolio mix, sales of products during the quarter accounted for 93% of total sales and grew 20% mainly due to the strengthening of our supply chain, the increased demand for water solutions and also the operative weakness that some of our competitors had during the period.

Sales of services accounted for 7% and decreased by 4% in spite of the strong performance of bebbia and drinking water fountains. This is due to the uncertain investment environment that affected new water treatment plants contracts and COVID mobility restrictions that affected the execution of projects as I mentioned before in Mexico's slide.

Bebbia reached more than 42 thousand installed purification units and the average ticket is increasing as people is choosing alkaline water or more sophisticated purification technologies as inverse osmosis. New consumption habits and macro tendencies like avoiding single use plastics, reducing carbon footprint and wellness, are boosting the purification platform.

About our balance sheet and cash position is important to highlight that we optimized our cash conversion cycle by 23 days as a result of the renegotiation with our clients, an initiative originated in Flow that continues to be closely monitored by the weekly cash control tower.

During the quarter, the strong operative performance contributed to increase our cash position in $201 million, to reach cash and cash equivalents of $3.4 Billion

As I have already mentioned, our Net Debt to EBITDA ratio is 0.5x, well below our 2x ratio policy.

Our debt position considers the sustainable bond AGUA 17-2x, which as we have discussed in the previous quarters, netted 4 billion pesos, has a maturity date June 16th, 2027 and was issued at an 8.65% fixed rate.

It also considers the $65 million pesos loan in Perú that we took last quarter, which was meant to help alleviate the pressure caused by the lockdown in this country. The loan has a 12-month grace period, 1.49% annual interest rate and a three-year tenor.

Our debt maturity profile allows us to be flexible and have enough liquidity to keep our growth pace for the flowing quarters.

Cumulative CAPEX remains at 3% of total sales, amounting to $207 million pesos of which $63 million were allocated to new water treatment plants in Mexico and Brazil, $26 million was allocated to Argentina for productive improvements in the waterflow business and $6 million for the digitalization of the customer service platform in that country. And $132 million for the execution of multiple initiatives within the Flow program.

I would now discuss our results in terms of creating value for our shareholders. As Charlie has remarked, we remain committed and on course towards our objective of having a ROIC greater than our WACC.

We reached a 9.8% ROIC, just 86 bps below the WACC that stands at 10.7%, representing the tightest gap between these two ratios in the last 17 quarters.

We have achieved this within the Flow framework by pursuing a diverse array of initiatives and actions, some of which we have discussed in previous calls and that can be summarized as follows:

- We created the cashflow control tower to ensure greater discipline in capital allocation.
- We have increased production efficiency in our manufacturing processes.
- We developed a divestment strategy for underperforming assets, like our former product unit in Brazil and our manufacturing assets in the U.S., enabling us to focus on new venues for growth with greater potential.
- The launch of new products and services. One example is Rieggo, a joint venture for intelligent water management in the agricultural sector in Mexico.
- Development of new sales channels and more effective sales force.
- Restructuring and realignment of the Company's human capital.
- Improvement in logistics with the Rotoplas Transportation Management System.
- And finally, we maintain a strict expenditure discipline across all our operations.

As Charlie said, we are committed to creating value for our shareholders while at the same time we are committed to ESG principles and best practices. We seek to have a positive impact while generating profitability. We have undertaken initiatives on talent development, client focus, climate change risk assessments, collaborative platforms and the development of key performance indicators and an objectives and key results approach.

The results of these initiatives are detailed on our ESG KPI Dashboard, which is available on our website. The dashboard details our most relevant Environmental, Social and Governance (ESG) results since 2016 and, together with our recently launched Sustainability Management System Platform, will strengthen our efforts to increase the update rate, measure and improve our ESG performance, while reaffirming our commitment to transparency and accountability.

Moving forward, our strategy is to grow our water-as-a-service platform, maintain our product leadership and pursue new business opportunities, as we have done with *Rieggo* in Mexico.

We will also seek to maintain our brand leadership in the Argentinean market, as well as continuing to implement a price policy in line with inflation and boosting our export platform. Additionally, we will continue to ensure that our operations are self-sustainable in terms of cashflow and that we don't take on any local debt.

Finally, we will continue with our current business development strategy in Brazil, Central America, Peru, and the United States, introducing new water solutions to our portfolio, exploring new distribution channels, and optimizing our operations.

As a company, we are uniquely positioned to have a positive impact for our customers and communities and to create value in the process, as Charlie said earlier. We have relied on the strength of our brand, our market leadership, our quality and innovation and our financial strength to address the present and future water needs of our customers.

As some of you may recall, back in February, before the current situation, we expected that in 2020 we would achieve:

- net sales growth equal or above to 10%
- EBITDA margin equal or above 18%.
- Net debt to EBITDA ratio below 2x.
- Return on invested capital above or equal to cost of capital. ROIC ≥ WACC.

We refrained from giving guidance in the first two quarters of the year due to the extraordinary circumstances we were going through. However, after all the efforts we have undertaken and our results, we are now confident that we will reach our original objectives for the year.

In the session held yesterday, the Board of Directors agreed to call an Extraordinary Shareholders' Meeting in November to propose a capital reimbursement in kind. The company will distribute shares that it already has in treasury.

For payment in kind the following is proposed:
i. Delivery to each holder of 18 shares of the Company, one share as payment in kind for the reimbursement.
ii. If in any case, the payment in kind with shares results in a fraction of a share, said fraction would be paid in cash to the corresponding shareholder.
iii. Date of payment between November 27 and 30 of this year.

Before the Q&A session I would like to mention that we were included in the FTSE BIVA Index of the new Bolsa Institucional de Valores, broadening investor access to our shares and reaffirming our position in the Mexican

Thank you very much for your attention.