

4Q15 and FY 2015 Earnings Call Transcript

4Q15 and FY15 Rotoplas Earnings Call

Operator:

Good morning and welcome to the Grupo Rotoplas fourth quarter and full year 2015 results conference call.

Please be advised 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 Tracy, 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 well as a corresponding presentation.

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.

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

4Q15 and FY 2015 Earnings Call Transcript

Carlos Rojas Mota Velasco:

Thank you, Nayelli and good morning everyone. 2015 was our first year as a public Company and I believe it was successful in many ways. We saw strong demand for our products and solutions which drove top line growth in almost all of our markets, coupled with improved operating and profit margins due to the successful implementation of a zero based budgeting plan which allowed us to maintain strict controls over expenses throughout the organization. These elements, combined with favorable raw materials prices, allowed us to produce what we believe are extraordinary results despite significant macroeconomic and political challenges in the region, particularly in Brazil.

We also made meaningful progress related to our core growth opportunities. To begin, we deepened our footprint and product portfolio in the Americas.

In the US, where drought and massive water and sanitation investment needs represent a substantial market opportunity, during 2015 we opened two new Rotoplas plants: one in California and one in Georgia, and the third one in Texas, started operations in January.

To update you on integrated solutions in Mexico, demand driven by the government-backed school water purifying fountain project finally took hold this year, and represents an important opportunity for Rotoplas in the future ahead. Last year the government had earmarked more than 1 billion pesos to install more than 10,000 fountains in schools throughout Mexico but were delayed until the second half of 2015 while appropriate guidelines were set. To date, less than 7% of the fountains have been sold and we expect demand to increase ahead of the 2018 deadline.

This year, the situation in Brazil negatively impacted most companies with a presence there and Rotoplas was no exception. However, we anticipated continued weakening in the economy and made quick decisions early in the year to reduce our presence in the country. We closed certain plants in Brazil and moved machinery to other plants in the region, which can be quickly relocated if volume in Brazil again picks up. We were able to achieve breakeven EBITDA for Brazil in the fourth quarter, mitigating the negative effects despite lower sales volume- a clear reflection of the strength of our business and management team.

Supported by profitable growth in the rest of our markets, we were able to absorb the negative effects, showing only 3.4% decrease in net income on a 13% decrease in total revenues, primarily the result of the decline in Brazil for the full year.

4Q15 and FY 2015 Earnings Call Transcript

Looking forward, while Brazil currently represents 20 percent of our sales, in the future we expect it to represent no more than 10 percent. However, we believe that eventually there will again be important opportunities in Brazil and we'll be able to increase our presence as quickly as we were able to scale down should the situation change.

I'd also like to comment that within the last month we began the process of acquiring two companies in Latin America: one that is a Mexican Integrated Solutions company focused on the commercial water treatment and recycling industry, a new area for Rotoplas, and the other a water heater manufacturer in Argentina, which strengthens Rotoplas' presence and portfolio in that country. We will provide further information to the market on these investments once we have further advance into the processes.

We faced many external challenges in 2015 but also some new exciting opportunities. Our performance demonstrates that we're handling both effectively. Strong demand for our products excluding Brazil, favorable product mix, strict cost control across our organization and the benefits of low raw materials prices resulted in solid performance for the fourth quarter and full year.

Looking forward to 2016, we laid the foundation for further profitable growth. Our focus on performance in this type of environment also makes us stronger when the markets turn. We therefore remain focused on our goal of doubling our business over the next four years by focusing on the core growth opportunities that I have described: first, tapping the U.S. market, particularly the Sun Belt area. Second, continuing to identify opportunities for integrated water treatment and sanitation solutions. Third, capitalizing on increased demand for drinking water in Mexico and by the government-backed water purifying fountain project in Mexico's school system. Finally, as I've commented, eventually we believe there will again be important opportunities in Brazil in the coming years.

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

4Q15 and FY 2015 Earnings Call Transcript

Mario Romero Orozco:

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

As we'd discussed, 2015 was a challenging year. However, as our results demonstrate, we were able to maintain profitability in our key markets despite the heavy headwinds coming from the South.

Looking at fourth quarter results, net sales decreased 12.5% year on year due to reduced sales in Brazil. However, it is important to note that sales excluding Brazil increased 14.4% year on year due to increased demand in both Mexico and Other countries.

Slowed sales in Brazil in both individual and integrated solutions resulted in a 10.5% decrease of individual solutions, year on year, and an 18.1% year over year decrease in integrated solutions.

We ended the quarter with a gross profit margin of 40.5%; a 290 basis point increase from the fourth quarter of last year. This improvement was due to better raw materials costs as well as improved fixed cost absorption in the fast growing countries during the fourth quarter.

Once again, we continue to benefit from lower oil prices which kept resin prices, Rotoplas' main raw material costs, low. This continued to offset any negative foreign exchange impacts we experienced during the quarter given our exposure to currencies in the countries we have presence in.

Fourth quarter EBITDA decreased 16.3% year over year, however EBITDA margin decreased by only 70 basis points; from 15.7% to 15% year over year.

Full-year 2015 net sales totaled 5.7 billion pesos, a 13% decrease from 6.5 billion in 2014 and EBITDA came at 771 million pesos, a 10.3% decrease from 860 million pesos in 2014. However, 2015 revenues excluding Brazil increased 20.7% EBITDA increased by 51.7%.

2015 gross margin was 40.4%; a 200 basis point increase from 38.4% as reported in 2014 due to lower raw material prices, improved sales mix and greater fixed cost absorption.

4Q15 and FY 2015 Earnings Call Transcript

Operational expenses as a percentage of sales increased 110 basis points year on year due to lower sales volume in Brazil, one-time non-recurrent costs related to reducing our presence in that country, as well as costs associated with ramping up our US operations. This was partially offset by the strict financial discipline and the zero based budget we have described previously.

Due to the measures taken in the first half of the year, the Company was able to report a 40 basis point year over year increase in EBITDA margin; from 13.1% to 13.5% despite EBITDA margins for the full year 2015 being negatively affected by the decline in sales in Brazil.

It is also important to reiterate that despite our decrease in 2015 net sales, net income decreased by only 3.4%; from 417 million pesos in 2014 to 403 million pesos reported for 2015.

I'd like to reiterate the fact that our results reflect the strength of the demand for our products as well as our success in anticipating and managing the negative effects of Brazil on our results. We remain focused on ensuring value creation for the Company and its shareholders. We were able to gain profitability in markets in which we are expanding while continuing to strengthen our footprint in the water industry throughout the Americas with benefit of our strong cash position; Rotoplas currently has a net cash position of \$2.3 billion pesos.

For 2016 results guidance, we are expecting an organic EBITDA of 1 billion pesos.

With that, I'd 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?

Operator:

Thank you. If you would like to ask a question, please signal by pressing star then one on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again press star and one to ask a question. We'll pause for just a moment to allow everyone an opportunity to signal for questions. As a reminder, it's star one if you'd like to ask a question.

We'll take Adan Rodriguez with Grupo Bursatil Mexicano.

4Q15 and FY 2015 Earnings Call Transcript

Adan Rodriguez:

Hello, good morning. My question is regarding the drinking fountain program. If you could comment a little bit further about it? Have you seen a ramp up in installations and if so, what we can we expect this to be reflected on your results? Thank you.

Carlos Rojas Mota Velasco:

Adan, good morning, this is Carlos. We just are experiencing in this week the first bid from the government for the water fountains and are starting with around 700 schools, and it is for the end of this month. We are working on the project, this is with the government within different states. Their plan is to have 40,000 schools at the end of 2017. So we expect that this is their first test or testing the alternatives, and we will start to see this opportunity starting this month. It's early to give any information about what to expect, we feel comfortable that we have a good solution for schools and that we will be able to participate somehow in a percentage of those 40,000 schools.

Mario Romero Orozco:

Just to complement on that, the way the government is thinking about them is including installation and maintenance. They're going to be doing about 10,000 to 12,000 per semester, and that's what we know so far.

Adan Rodriguez:

Great. Thank you. Have a good day.

Operator:

We will go next to Mauricio Santos with GBM.

Mauricio Santos:

Hi Carlos, hi Mario. I was also going to ask about the fountains, maybe a follow-up on this subject. How are you going to—there should be—the sales are going to be registered under Integrated Solution, I guess just want to confirm that, and how often would you need to do maintenance on these fountains.

4Q15 and FY 2015 Earnings Call Transcript

Mario Romero Orozco:

Yes, the water fountains are going to be classified in water Integrated Solutions, and the maintenance will depend on the water quality and the use of intensity, but we estimate that maintenance should be done every six months.

Mauricio Santos:

Okay. Are you budgeting this let's say from your guidance of \$1 billion EBITDA—are you factoring in sales from the fountain, from these fountains?

Mario Romero Orozco:

Yes, we are anticipating some of these water fountains to occur but not if this accelerates and happens to be 20,000 water fountains or so. So we are being conservative on we budgeted for 2016, but it could be bigger.

Mauricio Santos:

Okay, so let's say the maximum amount of fountains is 20,000 so you probably factoring in much more less than this 20,000 opportunity, is that correct?

Mario Romero Orozco:

Yes, that's the way we are seeing it.

Mauricio Santos:

Okay and what can you share with those about the opportunity of the water treatment plants? I know you probably can't discuss any details on the one you announced recently but are there many other water treatment plants or what is the size of the opportunity of this opportunity in Mexico?

Mario Romero Orozco:

What we can comment on the couple of inorganic opportunities that we have announced is that both transactions should add up to 15% of our revenue, both of them are accretive, also they will increase the profitability of our portfolio without considering synergies.

4Q15 and FY 2015 Earnings Call Transcript

So again those companies are complementary to our business strategy as we announced to the market and they have or increase our profitability to our business, without considering synergies that we will need to analyze going further.

Mauricio Santos:

Okay, and let's say I am thinking about CAPEX, you have roughly \$2.2 billion in cash, are you still having let's say, once you close these two deals, do you think that your cash levels will decline substantially or maybe what could you give any guidance on that subject?

Mario Romero Orozco:

At this point we cannot disclose more information on the transactions.

Mauricio Santos:

Okay.

Mario Romero Orozco:

We will in a timely manner announce to the market about the financial sides of these transactions.

Mauricio Santos:

Okay. Perfect, Mario. Thank you.

Mario Romero Orozco:

Thank you, Mauricio.

Operator:

We will go next to Daniel Rojas with Bank of America.

4Q15 and FY 2015 Earnings Call Transcript

Daniel Rojas:

Good morning, Carlos and Mario. Thank you for the call. My question is a bit in line with the previous questions. I want to go further into what you are seeing regarding your 1 billion peso guidance for next year. If we see the water fountains, what element in your guidance is also going to contribute to growth next year, is it the tank, is it piping, where are you seeing growth in 2016 beyond the water fountains? Thank you.

Mario Romero:

Well let me just probably go from North to South. As you know, we are penetrating the US market. We have three factories operating now in 2016 that will give us an increase in our top line growth. In Mexico apart from the water fountains, we are still doing rain water harvesting and now to the composting bathroom which is as we mentioned before, the potential there is huge in Mexico and we are developing good products and solutions to the market. In terms of individual solutions in Mexico, we are experiencing good demand from the retail so that is growing well. Moving to Central America, we've been having a good performance there in all fronts. Peru and all other countries we are having a good demand on our Integral Solutions and we are seeing to have some traction on Integrated Solutions in some countries, solutions that we are taking from Brazil and Mexico to these countries are starting to have kind of a good chance in countries like Peru or Argentina. So that's where we are seeing the growth in 2016.

We are seeing good growth in all the countries where we operate. Expect Brazil where we think there are still a lot of headwinds are going to be coming on this in the coming years.

Daniel Rojas:

Are you budgeting for Brazil to be negative in 2016 or you think you can turn positive there?

Mario Romero Orozco:

No what we think Brazil is going to be, as we mentioned during the call, is going to be breakeven and that's the objective of the Company. We want Brazil not to give us but not to take us out and as Carlos mentioned, we want to keep the foot there because

4Q15 and FY 2015 Earnings Call Transcript

opportunities there are still there, market share we still have a good market share, so we want to be there when things bounce back.

Daniel Rojas:

Okay, and my last question. Going beyond what you are doing in the US, in the last week we learned that Lowe's was increasing its presence in to Canada. If my understanding is correct you have a relationship with the Home Depot, but I don't know if this expansion to Lowe's or you could even think of expanding into Canada. Is this something you have looked at in the past or not?

Mario Romero Orozco:

No, at this point neither Home Depot nor Lowe's are inclined to follow us in the US, so we are not following them right now in our growth strategy.

Daniel Rojas:

Okay. Thank you, Mario.

Mario Romero Orozco:

Thanks, Daniel.

Operator:

We will go next to Marico Prado with Goldman Sachs.

Marcio Pardo:

Good morning, Carlos, Mario. Thank you for the call. I have two questions. The first one is still on the guidance, just a follow-up. If you guys are budgeting the acquisitions into the 1 billion pesos guidance that was just provided, and also more on the short-term dynamics of the business units, if you could provide some more color on the sequential growth for Mexico and Brazil. We have seen that when you look at sequential growth, Brazil was actually stronger in 4Q when compared to third quarter and Mexico was weaker in 4Q competitive quarter, and particularly Mexico, you commented during the third quarter results that Integrated Solutions had rebounded in Mexico in the third

4Q15 and FY 2015 Earnings Call Transcript

quarter. So I just wanted to understand. The revenues a bit lower in 4Q from Mexico, if it was due to a deceleration or some sort of deceleration in government spending. Thank you.

Mario Romero Orozco:

Back to your first question, Marcio, the 1 billion EBITDA that we gave as guidance, it's all organic so we are not considering any acquisitions in that number.

Then to the sequential growth: there is some seasonal time in winter related to Mexico. So there you see some of that in the numbers. As for Mexico, remember in the third quarter we did some catch up of Integrated Water Solutions that were not sold during the first half due to the delay in guidelines. So that is why you see a big job in third quarter from Mexico and then it came back to a more normalized level in the fourth quarter. I don't know if that addresses your questions Marcio.

Marico Prado:

Yes, yes. Thank you, and one quick follow-up. Just would you be able to give us a breakdown of individual and integrated for Mexico and Brazil in the fourth quarter.

Mario Romero Orozco:

No. That is information that we will not release, so at this point we are not able to do that much. Sorry about that.

Marico Prado:

Okay, no problem. Thank you.

Operator:

As a reminder, if you would like to ask a question or the phone its star, one and we will go next to Fernando Perez with GBM.

4Q15 and FY 2015 Earnings Call Transcript

Fernando Perez:

Hi, good morning Carlos and Mario. I have one follow-up question regarding your guidance. I was wondering what assumptions do you have for the oil prices- well actually your real prices and exchange rate- and how much will come from Mexican government? Thank you.

Mario Romero Orozco:

Well for the exchange rates Fernando we did the budget with the peso at 17.5 pesos to a dollar, a 4.20 reals to a dollar, and 13.5 Argentinean peso to a dollar and so on. Obviously, the markets are playing differently today, Mexican peso just went over 19, so I think FX markets are everywhere and the good part of it is that the oil has played to be the best hedge for the Company and goes hand in hand as the FX moves up, the oil goes down and in respect to what—how it affects the Company, it plays well. Because the oil drop has been larger than the FX. Arguably if the FX keeps appreciating than we will need to consider the Company to do a price increases in our product lines.

Fernando Perez:

Okay, thank you and just one more question. Do you still have accounts receivable from the Brazilian government and if yes, how much do you expect to collect during 2016?

Mario Romero Orozco:

We expect to collect about 50% on the accounts receivables we have with the Brazilian government and, just to give you a sense, last year we collected about a third of the outstanding debt, 2016 we expect to collect 50% on the past due receivables with the government, and also we are entitled to charge interest on the past dues with the government. So we are collecting money and we are not losing value in real terms. And just to finalize on the accounts receivables with the Brazilian government, they call it a *empeño federal* which is backed by the federal government so we feel comfortable that we have a good level of seniority in accounts receivable with respect to Brazilian payment and we are not losing value through time.

Fernando Perez:

Okay. Thank you.

4Q15 and FY 2015 Earnings Call Transcript

Operator:

We will go next to Mauricio Santos with GBM.

Mauricio Santos:

Hi. Thank you for the follow-up, Mario and Carlos. So as long as the FX returns to 17.5, you don't expect the resin prices to put weight on your margins. That will be correct?

Mario Romero Orozco:

Not, necessarily. That's how we did the budget at 17.5, but now with the oil prices where they are now, the Company—the FX can go all the way up to 18.5, 19 and we are still not need to increase prices. Obviously as I mentioned, if FX starts to appreciate, then we will need to consider price increases in our product portfolio.

Mauricio Santos:

Okay, so let's say at current levels the benefit of lower resting prices still truly upset the FX depreciation.

Mario Romero Orozco:

Yes, that is correct.

Mauricio Santos:

Okay. Thank you very much.

Mario Romero Orozco:

Thanks, Mauricio.

Operator:

There are no further questions at this time, but as a reminder its star, one if you would like to ask a question on the phone.

4Q15 and FY 2015 Earnings Call Transcript

Nayelli Corro:

We have a question from the webcast from Cynthia Lopez. However the question we don't see it so Cynthia, do you want to try one more time so we can read it. We will appreciate it.

Carlos Rojas Mota Velasco:

Are there any more questions? Otherwise just to close the session, I would like to comment that what we see as a growth potential in our markets means that the consumers have either to store water, purify or treat water with Individual and Integrated Solutions, and that's how we could have important growth in all of our countries, even Brazil which at this time we do not consider as a growth potential but they still have water needs.

Operator:

There are no further questions on the phone.

Nayelli Corro:

Okay, well we want to thank you for your time and your interest in Grupo Rotoplas and hope you join us again next quarter. Until then we'll be sure to provide you with important updates. Thank you again and good bye.

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4Q15 and FY 2015 Earnings Call Transcript

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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 the leading provider of individual and integrated water solutions for storing, carrying, and treating water in the Americas. With more than 35 years' experience in the industry and 23 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.