Grupo Rotoplas
4Q20 Conference Call

Operator:

Good morning and welcome to Grupo Rotoplas Fourth 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. Thank you for joining us today. As always, I am glad to have the opportunity to talk with all of you about the most recent results and what we see going forward.

As you all know, 2020 brought about a challenging environment for our societies and our economies. It was a test of our resilience and our ability to adapt and evolve, as individuals, as companies, and as societies. However, these challenges were also a unique opportunity to prove that our fundamental purpose as a company is more relevant than ever.

We aim to bring more and better water to our clients and communities. And we aim to do so through constant innovation and with a complete commitment to ESG principles and best practices. As the needs of our societies change, we continue to evolve.

In this context, I am proud to share with you today that, through the efforts of our team, we met and even exceeded the guidance given for 2020. We reached the highest level ever recorded in sales, adjusted EBITDA, and net income. And perhaps most importantly, we increased our return on invested capital to 240 basis points above our cost of capital, putting us back on economic value-creation levels, which was the main objective of our transformation program, Flow, which is in fact our new way of operating.

Our ROIC increased from, 9.3% at the start of Flow, in September 2019, to 12.4% in December 2020, a 300 basis points expansion in the first 16 months of implementation.

The challenges we faced and the results we obtained confirmed that we are in the right industry. As the need for water continues to grow and its scarcity demands smarter and more efficient usages, we provide solutions that help to address all kinds of water needs in a more sustainable and efficient manner, from storage, piping and rainwater harvesting to water purification and treatment through market-leading brands across the region. As such, our value proposition is aligned with megatrends that entail great growth potential and is also backed by a combination of business models that has proven to be successful and will continue to evolve through Flow.

Flow requires a constant reexamination of our strategies and operations and, even though it entails a significant additional effort for our team, it is now a key component of our organizational culture, with over 1,500 team members involved in the completion of 320 initiatives. Amongst other things, the program has contributed 1 billion pesos in additional sales, 300 million pesos to EBITDA and has enabled us to launch over 20 new solutions.

In just two years, 2020 and 2021, we will have launched more new solutions than in the previous ten years. Furthermore, we will continue to take full advantage of the synergies between our current operations and the market potential of our water-as-a-service platform.

Additionally, through our natural link and our efforts in sustainability matters, our ESG Scores given by diverse rating agencies have improved consistently during the last years. Positioning Rotoplas as regional leaders in this topic.

We appreciate that the markets have rewarded our transformation and sustainability efforts, as our stock price appreciated over 70% during the year, becoming one of the top five performers in the Mexican stock market.

To continue building on these results, this past December we launched the 2021-2025 business plan for sustainable growth, a roadmap that will enable us to achieve the following objectives over the next five years, and what we call "the twos and twenties target": We aim to double sales, increase EBITDA margin to 20% or above and improve the return on invested capital to around 20%. And we will work towards these objectives with a conscious capitalism framework, giving equal priority to people, profit and the planet.

Now more than ever, Rotoplas is committed to better serve our customers and communities, in alignment with ESG best practices and considering our stakeholders' interests. This will enable us to create value for our shareholders through sustainable growth, while promoting the well-being of our societies and the preservation of our planet.

I want to thank you for your interest over the last twelve months and since the beginning of our transformation. I hope you will continue this journey with us.

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

Mario Romero Orozco:

Thank you, Charlie. Good morning everybody. Thank you for joining us today.

As Charlie mentioned we are very happy and proud of what we achieved in a very atypical year.

2020 was certainly complex and challenging. However, as a company, we were uniquely positioned to have a positive impact on our communities and to create value in the process. We have relied on the strength of our brand, our market leadership, our quality and innovation and our financial strength to deal with the uncertainty and volatility that the pandemic brought about.

The following years we will continue to evolve the company and to pursue sustainable growth. We truly believe in conscious capitalism and we are positive on the extraordinary potential that companies have to do more good for more people in a sustainable manner than any other social or economic system.

Now, let's go over some of the key aspects of our results.

We did not experience any disruptions in our operations in the fourth quarter. Nevertheless, this required 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, including periodic testing and regular workplace sanitization measures. Our administrative staff continues to work remotely.

Moving forward to financial highlights, net sales increased 20% in the fourth quarter, reaching a historical maximum for the second quarter in a row, with double digit growth across all our markets. This growth compensated for the disruptions caused by the pandemic in the first semester as we registered 11% growth for the whole year. It is worth noting that sales of products increased 25% in the fourth quarter, still driven in part by the changes in hygiene habits and domestic water consumption brought about by the pandemic and the accompanying boost of e-commerce sales through our platform in the United States.

E-commerce has experienced exponential growth all around the world, particularly in the US, where it has increased from 15% to 26%, whereas in Mexico it has tripled representing close to 9% of all sales. We have explored and increased our participation in online sales in every region, through our own websites, through distributors webpages or as a lead generator, as is the case of bebbia's website.

These results attest to our ability to address customers' needs throughout our markets even in an uncertain and constantly evolving environment. Though some of the quarterly growth might be attributable to seasonal effects, we believe it showcases the potential that exists without pandemic-related operational restrictions. We are all, to be sure, still figuring out what the "New Normal" will look like. However, we are confident that our market leadership position and flow's execution discipline will enable us to accomplish our 2025 goals.

Gross margin had a contraction as we have hired additional personnel; what we internally call a "SWAT" team to keep productivity pace at the same time as complying with current sanitation guidelines.

Likewise, our operating margin decreased in 2020 due to the one-time expenses associated with the implementation of health and safety measures, which amounted to $40 million pesos, $10 million in donations and the accounting of $167 million in expenses associated to the Flow program.

Our adjusted EBITDA, accounting for one-time expenses grew 18% in the quarter and 5% in the year. COVID-19's annual impact amounted to $160 million, around $120 million due to operating restrictions and the already mentioned $40 million expenses related to the implementation of sanitary protocols.

I would like to highlight that normalized SG&A expenses would have grown 8% in the year, figure lower than the 11% sales growth, showing an improved operating leverage.

Net profit before discontinued operations, that is, the divestment of our product business units in the US and Brazil, grew 55% in 2020. Net income after discontinued operations, increased 8x when compared to 2019.

Now, as to our geographic breakdown.

Sales in Mexico grew 11% during the fourth quarter and 10% during the year, due to the strong demand for our storage, waterflow and improvement products, including the new ones that were added to our portfolio as a result of Flow. Our star launchings were the dual tank, a product that can be used as a water tank or as a cistern, and the ultra-flexible pipes.

Products' growth compensated the slowdown in services sales. We will further discuss the service platform performance in another slide.

Net quarterly sales in Argentina grew 25% in local currency, driven by double digit growth across all three categories: storage, waterflow and water heaters as well as a growing share of the export business, which grew by double digits and now accounts for 5% of total sales.

In 2020, sales grew 32% in local currency, but the depreciation of the Argentinean Peso resulted in a 1% decrease in Mexican pesos. Furthermore, as I mentioned in our last call, the operating restrictions we faced on that country negatively impacted our sales during the second and third quarters. Nevertheless, our leading brands, pricing strategy and strict expense discipline helped to increase our EBITDA, as we continue to introduce new lower-end products and to gain domestic market share.

Sales in the United States grew at a double-digit rate during the quarter and the year, due to the changes in water consumption as people spend more time at home as well as to the optimization of our e-commerce platform, which has enabled us to increase the sales conversion rate of our websites. We serviced more than 25 thousand customers through our platforms during the year.

Sales across all countries in Central America increased by double digits during the quarter. The region also grew by double digits in 2020, thanks to the optimization of our sales force productivity and the incorporation of new products to our portfolio, which have increased our customer base.

Sales in Peru increased by double digits in the fourth quarter and in the year. The recovery trend that followed the June reopening, combined with the introduction of 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 as part of the profitability initiatives within the Flow framework, we continue to focus on strengthening the presence of our water-as-a-service platform in that key market. We now have three water treatment and recycling plants in the country.

In terms of our portfolio mix, sales of products during the quarter as well as for the year accounted for 93% of total sales, growing 12% in 2020. Sales of services on the other hand decreased 2% in the year, due to the closing of schools, which affected our water-fountain business in Mexico, as well as the negative effects of the pandemic on investments in water-treatment and recycling plants, which affected our contract pipeline. Nevertheless, our drinking water platform, bebbia, continued to grow, registering record sales, and doubling its client base to reach more than 44 thousand users, which is very encouraging.

In addition, we have high expectations for our new joint venture, Rieggo, which provides smart water solutions for agricultural producers. Rieggo registered its first sales during the quarter.

Our government sales as a percentage of total sales amounted to 5.2% in the fourth quarter and 5.3% in 2020, well below our 10% goal.

We optimized our cash conversion cycle by 17 days, and we continue to review our terms with related parties through the weekly cash control tower.

Our net debt to EBITDA ratio is 0.6x—well below our 2x ratio policy. And it is worth noting that 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 in June 2027 and was issued at an 8.65% rate.

During 2020, CAPEX was 3% of total sales, amounting to $291 million pesos, of which 30% million were allocated to new water treatment plants in Mexico and Brazil, 15% was allocated to Argentina for productive improvements in the waterflow and heater business and 6% was invested in the optimization of the e-commerce platform in the United States.

As some of you may remember, we have a specialized committee to enhance control and accountability across our businesses. The capital allocation committee ensures not only that every project fulfills our criteria in terms of internal rates of return and net present value, but more importantly, that it is aligned with our comprehensive strategy. Furthermore, as the committee keeps track of the resource allocation and the preliminary results of each project on a quarterly basis, it is possible to adjust in an agile fashion.

As result of this process, our annual net sales grew over 10% even as our CAPEX decreased by a little less than 12%.

As Charlie already mentioned, we went from a 9.3% return on invested capital in September 2019 to a 12.4% one in December 2020, thus achieving the objective we set out for Flow. This involved pursuing various initiatives and actions, which we have discussed in previous calls, but I would like to recap briefly:

- We created the cashflow control tower to ensure greater discipline in capital allocation.
- We have optimized working capital.

- We have increased production efficiency in our manufacturing processes.
- We developed a divestment strategy for underperforming assets, like our former product unit in Brazil for example, enabling us to focus on new venues for growth with greater potential.
- And finally, we maintain a strict expenditure discipline across all our operations.

Our commitment to sustainable growth translates in our full commitment to ESG principles and best practices. In our last call I commented that we are publishing the results of our ESG initiatives through our ESG KPI Dashboard, which is available on our website as well as other relevant information about our efforts. I would now like to highlight some of the actions we took in the space during the fourth quarter.

First, we filled out the Carbon Disclosure Project climate change questionnaire for the first time. The questionnaire measures our environmental risk in the interest of transparency and accountability. CDP released the companies' scores during the quarter and Rotoplas received a "Management" or "B" score, which means that we are taking coordinated action on climate issues, ranking above the mean of most Mexican public companies.

We organized the first Construction Industry Trends Virtual Forum in November, a pioneering effort to provide widespread access to expert insights on sustainable architecture and design to Mexican construction professionals. It was also a great forum to launch the rebranding of Tuboplus, one of our water flow brands in Mexico.

We continued with our disaster assistance program, PAZA, which as you may remember was redirected to providing pandemic help as PAZA C-19. As part of the program, during the quarter we established an alliance with the Red Cross and Harpic, the cleaning products company, to install hand-washing stations in Mexico City's main market "La Central de Abastos", a contagion risk hotspot, directly benefiting over 12,000 people. Likewise, we joined Habitat for Humanity's "More than just a bathroom" initiative in Argentina, where 6 million people don't have a bathroom in their home, donating waterflow solutions and building materials benefitting fifty families.

Finally, we updated our materiality assessment using both, the Global Reporting Initiative and the Sustainability Accounting Standards Board methodologies. As you know, this analysis enables us to identify and prioritize the key ESG issues that have the largest impact on our stakeholders, business operations, and financial risk.

As discussed earlier, our 2021-2025 business plan for sustainable growth, has the goal of doubling sales and increasing profitability, making Rotoplas a two-factor story: a growth but also a value investment.

In the short term, 2021 specifically, we expect net sales to increase 10% or higher, an expansion in the Adjusted EBITDA margin to achieve a figure equal or above 19% and to keep Net Debt over Adjusted EBITDA ratio below 2x. We also expect to continue creating value as we maintain our return on invested capital at least 100 basis points above our cost of capital.

Before we turn over the call to your questions, I would like to make a brief comment about our stock's valuation. AGUA was one of the top five performers in the Mexican stock market, appreciating 70% in 2020. However, we believe there's still significant room for growth.

If we consider comparable companies in the different categories in which we participate, which you can see in the slide, our growth rate is 7 times that of the list's average and our EBITDA is expected to grow three times as fast. Furthermore, the average Enterprise Value to EBITDA multiple of these companies is 14.6x, while Rotoplas' is 9.1x, implying a close to 40% undervaluation.

Mariana:

Thank you, If you have any question, comment or suggestion please feel free to reach out, we will be more than happy to hear from you.

Have a nice day and see you next quarter.