

## Q1 2018 Earnings Call

### Company Participants

- Guilherme Setubal Souza e Silva, Executive Manager-Investor Relations
- Unverified Participant

### MANAGEMENT DISCUSSION SECTION

#### Operator

Good morning, ladies and gentlemen, and welcome to the audio conference call of Duratex. Thank you for standing by. At this time, all participants are in a listen-only mode. Later, we'll conduct a question-and-answer session and instructions to participate will be given at that time. As a reminder, this conference is being recorded.

I would now like to turn the conference over to Mr. Guilherme Silva, Investor Relations Executive Manager. Please go ahead, sir.

#### Guilherme Setubal Souza e Silva {BIO 20114864 <GO>}

Good morning, everyone. First of all, sorry for the delay. We had some issue in our telephone number. And thank you for joining us in this Duratex conference call. We are here today to present our results for the first quarter of 2018.

I'll begin my presentation on page number 2, where we will discuss our consolidated results. Please turn to slide number 2 and here they discussed the consolidated results and highlights of this first quarter 2018. Generally speaking, we had a positive first quarter. Economic environment was more stable than previous year's quarter, which was favorable to our operations. We have seen an improvement in sales, especially in our Wood Division, and a positive contribution from the incorporation of Ceusa, through which we offer solutions in ceramic tiles.

Our consolidated net revenue grew versus the same period of last year and closed the quarter at BRL 1 billion, with improvement in the gross margin. The recurring EBITDA was BRL 182 million [Technical Difficulty] (00:01:54-00:01:55) of more than 30% year-on-year with 18% of EBITDA margin.

We've posted a positive result of the period. Here, I'd like to highlight the benefits in cost control and productivity resulting from the initiatives that compounds the Duratex Management System. Discipline in costs and expenses control has proven to be a highly important factor in the recovery of our operation, especially in a market that is in many ways is too challenging.

We have reached BRL 31 million in net profit in the first quarter of this year after having registered losses in 2016 and 2017 in the first quarter. We are in a right path and positioning ourselves to capture the return of demand within our market.

The perspective for the year is positive, but we must not lose track of the uncertainties of our market and we are monitoring closely the return of activity in our operation. We are more optimistic, but we still remain cautious.

Now, let's turn to slide number 3, where we present the results of the cash generation and corporate debt. In the slide number 3, we have the free cash flow and the debt. The highlights here is the consistency of our deleveraging strategy, which I have been discussing with you over the last few quarters. We have been able to slightly reduce the company's financial leverage this quarter.

The improvement in the cash generation combined with a stronger EBITDA has reflected a more favorable environment and a better performance in costs and productivity. We have had a few investments in working capital, welcomed by an increase in the volumes of sales during the period. The reduction of working capital remains one of the main priorities of Duratex Management System.

We've explored these in more details further on. In terms of investment we have made, we have remained consistent in the rationalization of assets, which we have explored through various opportunities. The focus of investments continues to be in the sustaining of our business, only that.

We had in the beginning of the year a few relevant cash withdrawals, such as investment in minority stake of Viva Decora around BRL 6 million and remainder of acquisition of Ceusa, we're talking about BRL 70 million disbursement in general.

There is also the distribution of dividends, interest on capital refrained in period of 2017. This and other effects pressured our cash generation, which was negative in this quarter. However, it's worth highlighting that the cash generation is presenting a positive evolution in line with the initiatives that have been put in place. The result is that we had a slight improvement in the leverage of Duratex of those hinder periods of leverage.

Next slide, I will explore the evolution of our working capital in details. So, right now, please turn to page number 4. And the idea here is to explore the working capital and the CapEx of the quarter. We have started to see an improvement in our cash conversion cycle, which reduced in 8 days in this quarter. One of the main factors in this movement was improvement (00:05:39) days and longer days' payment to our suppliers. The expansion continued to see better results throughout the year. (00:05:49) our cash generation and deleveraging process.

Our focused investment is on the sustaining of our operation. This reinforces our commitment to the long term because of continued investing in forestry and (00:06:04) within the period. The total CapEx was BRL 81 million, below the first quarter of 2017. Our forecast for this year is above BRL 500 million (00:06:14), slightly above last year. We

seek to rationalize our investment without compromising the sustainability of our operation.

I end here my remarks on the tax consolidated results. We will now approach each of our business starting with the Wood Division on slide number 5. Right now, I'll pass the word to (00:06:38).

## Unverified Participant

Hello, ladies and gentlemen, good morning. This is (00:06:43) speaking. So, I'll start my comments on slide number 5 regarding the Wood Division. We are satisfied with the overall performance of the Wood Division which started showing the first signs of recovery in the beginning of the year. We have noted a more heated market in the last three months with the net volumes growing at 3% and exports growing at 8.5% in the Brazilian domestic market and export markets of wood panels.

This data shows that the export dynamics, which have been relevant to local price level, should continue throughout the year. Our sales volumes have grown 2.5% in the period mainly due to the furniture industry (00:07:26) products with lower value-added. Therefore, we have been seeing a slightly worse mix of products. The net revenue has followed this increase in shipments and closed the quarter at BRL 628 million.

Gross margin showed an important improvement year-on-year moving from 21% to 27%. This result is largely due to the substantial price increase implemented during this time and positive cost performance. We have also seen excellent individual performance during this quarter with productivity levels among our units of production at historical heights.

EBITDA amounted BRL 120 million with a margin above 20%. We must keep in mind that there was a lower volume in the sale of timber to third parties during this year, especially because of the sale of forest assets to Suzano. We will have a [Technical Difficulty] (00:08:28) right now. In the first quarter for example, [ph] we saw (00:08:33) BRL 12 million less in the first quarter of 2017.

Besides these, we also raised our cost of almost BRL 10 million regarding the reopening of Itapetininga. Despite this pressure, the improvement in our results reinforces that we are on the right track in terms of commercial and management initiatives.

Now, I'd like to take a moment to comment on the reopening of the Itapetininga on slide number 6. So, as I was mentioning before, it is with great satisfaction that we resumed the operations of the MDP and MDF lines in our unit in Itapetininga in the beginning of April.

So, this reopening has an impact of almost BRL 10 million that is already accounted in the first quarter results. When we temporarily shut down these units in December 2015, more than three years ago, we committed to resume activities once the market shows some signs of improvements. We have been planning this movement since the second half of

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last year, and during this process, we have hired former employees from the units. In fact, 90% of our current staff are returning employees.

The reopening of Itapetininga, our most modern unit, the newest one that we have, will bring greater flexibility to our operations, allows us for better service level and positive impacts on our results during the year. At this moment, we're operating on what we call a flex model, using almost half of our capacity alternating between the MDP line and the fiberboard line production. We may accelerate production as we see improvement in demand during the year.

I finish here my remarks on the Wood Division and I invite you to turn to slide 7, where we present Deca's results. So, the news here is that for this year we have adjusted our structure to better focus on our new business from ceramic tiles. Therefore, we are going to split the results from Deca and Ceusa during our disclosures.

We are still facing a very challenging environment in Deca Division. The civil construction cycle may take a while longer to show some improvement. For the time being that we are talking right now, we see remodeling as the main driver of growth for our sales.

The signs of improvements are still shy and the forecast of ABRAMAT that is the main proxy for this division is a growth of something closer to 1.5% for the year. In addition to this challenging environment, we're still seeing, I would say, more competition among Deca's industry.

As a consequence, we have seen lower shipment volumes in Deca, versus the same period of last year. The fall was mainly concentrated in ceramic sanitary ware and electronic showers. Along with lower volumes, we have registered a slightly worse mix of products, which has also pressured Deca's results.

EBITDA in the quarter was BRL 46 million, with a 14% margin. The low occupation of our production lines and the increase in prices of raw materials, including the main commodities that we usually buy were really hard for our performance. We should see a revenue recovery along the year.

Having in mind this challenging environment, I would say that we are intensifying our initiatives within Deca and using the Duratex Management System to review our structure and to be much more leaner and dynamic.

Now on the slide number 8, I will present the results of our most recent business, ceramic tiles. So, our operations in ceramic tiles take place through the brand Ceusa, a company that we've have acquired in the second half of last year. Through a combination of a lean operation, high capacity utilization, successful commercial positioning and innovative solutions, we have reached the achievement of 1.2 million square meters that has reflected on the net revenue of BRL 44 million. The EBITDA during the quarter was BRL 10 million with a 23% margin, the highest one that we have in the portfolio right now.

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We are very satisfied with Ceusa's performance so far, which is above our original expectations and above our budget for 2018. We believe that gradually the integration of our operations will generate even better results.

I'd like now to present you guys on page 9 the highlights of our participation in Expo Revestir. So, Expo Revestir is the main event in the building materials and finishes sector. (00:13:50) participation was one of the highlights of the event. We used this base to start training (00:13:56) and to present new solutions to professionals and entrepreneurs.

This year we focused on the synergies of our portfolio by presenting living space using several solutions for the whole brands that we have, Deca, Durafloor, Duratex, and Ceusa.

I invite you all to participate in the 19th addition next year.

I'd like now to turn to Guilherme who will discuss where we stand in terms of the strategic products that we have announced in the beginning of this year. Please, Guilherme, go ahead.

### **Guilherme Setubal Souza e Silva** {BIO 20114864 <GO>}

Thank you, (00:14:31). So, as (00:14:33) said, we are here, you should go to slide number 10, the strategic projects that we released in the beginning of the year. Starting with Duratex, we are waiting for CADE's approval with regard to the sales of installation and equipment dedicated to the production of thin wood fiberboard through CADE. We'll keep you informed as soon as we obtain the approval and move on with this transaction.

Regarding Suzano, the sales of land and forests, we had obtained the approval from CADE of the first tranche of the deal, this part including the sales of around 10,000 hectares of land and forests and the value was BRL 300 billion. We accounted a value in April, which will therefore impact our second quarter results, and half of that we received in cash in the end of last month.

Regarding the second tranche of the deal, as you know, we issued a call option for Suzano to purchase an additional 20,000 hectares of land and forests, and the value was BRL 750 million. This option is exclusive to Suzano and is valid until July 2. We do not have an official position for Suzano at this time, but we will keep you informed in accordance to the law.

So, please let's turn to the next slide, slide number 11, and the idea here is to discuss the strategy of the company. We are a challenged organization to balance; on one hand, asset allocation and deleverage process; on the other hand, the growth in the business as usual. The focus of our strategy is to increase the returns of our assets.

To address this assets allocation, we are revisiting our asset base through means of the deep analysis of potential for value generation. An example of this investment we have

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made through the sales of our lines of thin wood fiberboard, (00:16:34) for example, and the sales of forestry and land to Suzano.

We are also acting in terms of working capital and CapEx, seeing to maximize the Duratex's potential cash generation. These all taking place at the same time as an effort to simplify the organization, making us linear and efficiency. Simplicity is one of the main principles of our new contra model (00:17:01).

This revision of our asset base does not have the objective of making our organization a smaller size. We are making precise adjustments in order to grow from hereon. Part of this growth, we are taking place in a gradual manner, as our capacity utilization returns to the higher levels. We have prepared during the crisis for this moment of recovery and we start to see the first signs of a healthier market in the segment that we operate.

In line with our new value proposition of solutions for better living, we are evaluating alternatives for growth within the four avenues that we have discussed with you on the previous part. This growth is taking place through an asset light model, seeing the opportunities (00:17:55) that they are attractive in terms of return on capital invested.

Finally, we'll not lose focus on our initiatives in cost management and productivity. We'll continue to implement initiatives under the umbrella of Duratex Management System. We are working to place Duratex in a higher level of competitiveness and we are gradually bringing (00:18:18) concrete examples of this transformation.

I end here my presentation, and now I'm open to any questions you may have. Thank you.

## Q&A

### Operator

Ladies and gentlemen, we will now begin the question-and-answer session. Our first question comes from (00:18:54) with Citi.

Hi. Thank you, guys. Good morning, everyone. So, my first question is on exports in the Wood Panel Division, you guys mentioned right that you're seeing good momentum there continuing, I'm curious what type of wood panels are you exporting, and if you can give us a sense of how profitability stands today given that the BRL has kind of weakened around BRL 3.50 (00:19:19), I'm curious how is profitability relative to domestic sales over same types of wood panels.

And my second question is more on just the capital allocation and also your leverage on your balance sheet. How do you see your leverage progressing through this year and really in the context of motivating for further, either acquisitions or investments. Is there a specific level of a leverage ratio that you want to get to before you get more aggressive approach, or should we see kind of like the small deals here and there that can just keep

leverage at the current state of around 2.8, 2.5 around there? Just to get any visibility there on kind of cash use for growth? Thanks.

Okay. So, (00:20:09). This is (00:20:10) speaking. I'm going to answer your first question, okay. So, exports for sure is performing on a positive trend. (00:20:21) for the whole industry since the - I would say since 2014, FX rates are much more helpful right now than they were last year, with this level of (00:20:33) of 3.5.

We export usually MDP and MDF, so the same panels that we export here (00:20:42) and we are originally improving the mix in exports. Right now, the mix is really poor. We usually export standard (00:20:50) fiberboards. I believe that forex range is going to continue despite of what is the FX level. So, with the FX at 3.5 or if the FX with 3.0, we are going to continue exporting, while we're going to manage better, it's one of where the markets that we are exporting.

So, (00:21:14) FX is much more helpful for exports as it is right now, I would say that we have more of (00:21:21) in terms of different markets. The profitability is still lower than the domestic market, but it's important to keep in mind that export is a rich management strategy for the company. So, we are working on improving net sales through a better management of the supply and demand level in the local market. So, I believe this trend is going to continue. It might see an improvement in exports for the industry and (00:21:51) in 2018.

Now I'd like to turn to Guilherme who's going to explain you about capital initiatives.

### **A - Guilherme Setubal Souza e Silva {BIO 20114864 <GO>}**

Thank you, (00:21:59). So, regarding your second question, capital allocation. So, as I mentioned during the presentation, we are very focused on the leverage process of the company, right? So, I mean, we reduced the leverage of the company just a little bit quarter-on-quarter when you compare first quarter 2017 against first quarter 2018, but it's important to mention here that you have some disbursement on some withdrawals - I mean, on a spot basis, right?

So, for example, in this quarter, we had a payment of BRL 70 million from acquisition of Ceusa, (00:22:40) of acquisition of Viva Decora, and we paid the dividends and interest on our capital in this first quarter. If we exclude this disbursement, if we can say this way, we generated cash in this first quarter. Our perspective for the next year is to continue this positive trend in terms of cash generation, right? So, focus on cost reduction and gain of productivity, right? And I mean, we really believe we can reach the end of the year if we include the payment from the first tranche of the deal with Suzano plus the cash generation, probably we will reach at the end of the year close to two times net debt to EBITDA, right? So, that's our perspective over the year. Okay.

### **A - Operator**

In addition to Guilherme's remarks here, it's important to mention that every flow that we have regarding cash, we're going to use for leverage, so that's the main priority for the

company right now, that these two operations is (00:23:42) below two times leverage ratio, I think.

**A - Guilherme Setubal Souza e Silva {BIO 20114864 <GO>}**

Thank you, (00:23:48). And I'd like to reinforce that we will pay the debt with this cash from Suzano and the cash generation as we mentioned in our material facts when we released this deal, okay.

**Q - Operator**

Great. Thank you very much.

This concludes today's question-and-answer session. I would like to invite Mr. Guilherme Silva to proceed with his closing statement. Please go ahead, sir.

**A - Guilherme Setubal Souza e Silva {BIO 20114864 <GO>}**

Thank you for joining us in this first quarter Duratex conference call. Our IR team is available for any further information you may require. Thank you very much. Have a nice day.

**Operator**

That does conclude the Duratex audio conference for today. Thank you very much for your participation. Have a good day, and thank you for using chorus call.

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