Y 2020 Earnings Call

Company Participants

- Antonio Joaquim de Oliveira, CEO
- Carlos Henrique Haddad, Director of Administration & Finance

Other Participants

- Caio Greiner, Analyst
- Marcio Farid Filho, Analyst
- Thiago K. Lofiego, Analyst

Presentation

Operator

Ladies and gentlemen, thank you for holding. And welcome to Duratex' conference call, which will discuss its 2020 -- the Fourth Quarter 2020 Results. (Operator Instructions) Before we continue, we'd like to clarify that any statements made during this conference call about the company's business perspectives, projections, operational and financial goals are merely beliefs and promises from the company's Directors, based on the information that is currently available. Future remarks are not a performance guarantee because they involve risks, uncertainties and assumptions. They refer to future events and therefore, depend on circumstances which may or may not occur. Investors should understand that the general economic conditions, industry conditions and other operational factors can affect the company's future results and can lead to results that differ materially from those expressed in such forward-looking statements. Now, I'd like to pass the floor to Mr. Henrique Haddad, the Vice President of Management, Finances and Investor Relations.

Mr. Henrique, you may proceed.

Carlos Henrique Haddad {BIO 17599460 <GO>}

Good morning, everyone. Welcome. Thank you for listening into one more conference call from Duratex. I'm here with Antonio Joaquim, our CEO; and Izzo, Marcondes and Menegon, who lead different businesses in the company. On Page 3. A brief recap of the year. We see that even despite all the challenges we faced in 2020, we were able to react quickly and effectively capturing the different market opportunities, which confirm this as a historical year for Duratex. With the quick creation of the Crisis Committee, we took all the measures needed to ensure the business continuity and safety for our 13,000 employees, with new strategies about working from home and reinforcing cleaning in their units. It's worth also highlighting that we helped the community during this time. We used over BRL 10 million in initiatives to fight COVID-19, including donating products from our Portinari and Deca brands to make-shift hospitals and public hospitals.

The First Quarter of 2020 started above expectations. However the impacts of social distancing and partial downtime in the industry were felt in our results, especially in the Deca and Ceramic Tiling Divisions. The sharp drop in demand seen in March and the lack of visibility on a future demand because of the crisis led us to capture BRL 1.6 billion, ensuring our financial liquidity and the continuity of our structural projects, such as the construction of our new dissolving pulp unit.

Temporary suspension in nearly all manufacturing units, inventory management from our suppliers and having a close connection to our clients were other examples of actions we took during the peak of the pandemic without, of course counting on all the work in protecting the Duratex team.

So by advancing our maintenance schedule, making use of any downtimes we had and retaining all of our employees, we were able to recover our operations quickly during the Second Quarter. As construction material stores reopened and demand went up again with the emergency aid and with the reduction in interest rates, our quick recovery led us to record levels of capacity utilization in a short amount of time, which were reflected in the results for the second half of the year, as you can see on this graph.

Moving on to Page 4. Just as in the Third Quarter, demand, maintenance and also maintenance of the productivity activities implemented in the last years led our EBITDA to grow 85% in the Fourth Quarter versus the same period 2019. While this was 42% for the year, it came to a total of BRL 1.288 billion, the company's best historical result. It's important to highlight our EBITDA margin levels reached this quarter, they were 27% for the quarter and 22% for the year. This level was only possible due to the restructuring and productivity activities that we started in the last years.

Another important factor was a well-managed price hike management for all divisions to offset the negative effects of inflation in the last month and to preserve our margins. With Duratex's performance this year, we reached a positive recurring EVA across all of our divisions, advancing by three years our own established goal. This is a very pleasing result, and it shows that we are on the right path.

We now continue with a cash flow analysis on Page 5. As we've said in the last meetings, with the pandemic, we had to reorganize our structure and our production flow to continue servicing clients. But with the lowest impact possible to our cash, the main challenge was maintaining product availability with a quick adjustment of the production facing the current demand and also an effort in servicing clients with a significant reduction in inventory, which reached their lowest historical levels in some businesses. Besides that, we cannot ignore our supplier management strategy, which were reviewed and allowed us to increase to 45 days in our average payment term. Considering this improvement in working capital, we closed 2020 with a record cash generation of BRL 1.1 billion without including growth projects that included over BRL 500 million in LD pulp for the construction of our new dissolving pulp unit. On CapEx, we were able to finish the year at a lower-than-expected level, a total of BRL 462 million. This took place, especially because of a reduction in expenses due to the pandemic.

Looking at the impact of this result on our indebtedness, we will continue on Slide 6. There was a strong increase in operational results and a high cash generation, which more than offset the effect of the crisis, taking our debt to 1.2x the net debt-to-EBITDA ratio. This result goes to show the company's financial solidity and our efficient crisis management. With the debt and with the reduction in leveraging, we were able to advance payment in some of the resources we captured in the beginning of the year, liquidating BRL 510 million this year.

We reduced the company's exposure to short-term debt and reduced its average cost. Finally, this quarter, we announced that we would pay JCP its total value of BRL 217 million and additional dividends of BRL 300 million, taking our dividend yield to 3.9%.

Now, to talk a bit about our divisions, let's continue on Slide 8. According to IBA data, the wood panels market went up to 23.4% in demand versus the same quarter last year, 27.5% in MDF and 18% in MDP. Volumes had a grow of 23.4% in the internal market and 20 -- nearly 23% in the external market. Over the year, the market had a growth of 6.5% versus 2019, 2.8% in MDP and over 9.3% in MDF. Exports went up by nearly 6% during this period. Now, to look at Duratex, we continue on Slide 9. Before going into details, it's worth recapping what the year was like in the Wood Division. We started 2020 with an above-average performance despite the impact of the pandemic in the First Quarter. Even with the effect of the crisis during the Second Quarter, we managed to implement a quick recovery, reaching volumes close to full capacity utilization, which were kept throughout the rest of the year. We finished the Fourth Quarter with a growth of 84% versus 2019.

The scale and productivity effect added to our price hike strategy due to inflation, which grew during this period, were essential for the operations results to evolve as we can see on Page 10. This quarter, the division expedited 30% more than the Fourth Quarter of 2019, 13% above last year. This is justified by the company's recovery strategy, our product position in the market and by the strengthening in our relationships with clients.

There was a highlight in increased market share for all product lines, especially covered products, which grew in sales by 35% this quarter and 14% year-on-year. For the foreign market, exchange devaluation and our strengthening in exports took us to new markets, which allowed us to increase our exported volumes by 30%. Once again going over what happened for the industry as a whole.

Another positive highlight was our successful price increase strategy, which led to an increase of nearly 13% in unit revenue in the Fourth Quarter of 2019 with a growth of 46% in our net revenue. This performance led the Wood Division EBITDA to grow 84% in the Fourth Quarter and 38% for the entire year versus 2019.

Moving to the Deca division, we'll continue on Slide 12. The civil construction materials market, after suffering a short -- a sharp drop in the first half of the year, improved throughout the second half according to ABRAMAT data, which showed an average increase of 12.5% in the Fourth Quarter versus 2019, resulting in a stable performance for the entire year.

Looking at Deca on Page 13. In the First Quarter, impacted by flooding in its metal unit in São Paulo division, still had a smaller demand as the economy closed in the early pandemic, which started improving after stores reopened.

In the Second Quarter, even with record sales for the Hydra brand, which offsets some of the reduction in total volume, results were still impacted by the pandemic with a reduction of 64% versus the Second Quarter of 2019. However by strengthening commercial actions in several markets, marketing activities with clients and a strong recovery in the refurbishment industry, we had a higher level in the third and Fourth Quarters, which had consecutive production and invoicing records. We'd like to highlight the marketplace which was launched for Deca in the Third Quarter of 2020. With this movement, we aim to get closer to the end consumer and have a better product position, follow the online buying trend that took place in the pandemic. This was a strong step for Duratex and its brands on the long run. Now looking at our results, we continue with Slide 14. Deca continued with a strong result in the Fourth Quarter.

Our volumes sold were 21% higher, and the division's net revenue was up by 25%. The priority given to the operational efficiency pillar in the last years led to -- company to consolidate its assets, reducing strategically the number of SKUs and finding asset-light solutions to launch new products, connected to cost reduction projects and increased productivity in plants, which made the unit cash cost of the division to go down by nearly 5% versus the Fourth Quarter of 2019. Due to this, we finished the quarter with an adjusted recurring EBITDA 87% higher than the same period 2019, a margin of nearly 23%. For 2020, our EBITDA growth was 25% versus 2019, a total of BRL 306 million.

Now, to discuss Ceramic Tilings, we continue on Page 16. The ceramic tiling market according to ANFACER data presented this quarter an average growth of 12.1% versus the Fourth Quarter of 2019, while this growth was 2.5% for the entire year. The industry's utilization levels were 84% of utilization this quarter, which was higher than the Fourth Quarter of 2019.

For more details on Ceramic Tilings for Duratex, we continue on Page 17. Before we begin, it's important to remind you that we concluded the Cecrisa acquisition in August 2019, which will generate some discrepancies in the yearly comparisons. The Ceramic Tile Division started the year attempting to capture synergies between the Ceusa and Portinari brands and concluding our ramp-up in the new line, the 4 -- the first 4.0 industry of the company.

Just as in Deca, the slowdown in the economy really impacted the division showing a negative result in the Second Quarter. The scenario started to resolve in the Third Quarter when utilization levels went up again. Considering synergies, this was a year of major achievements. We accelerated initial plans with above-expected results. Brands were integrated and the Ceusa brand performed very well on social media with promising results.

We now continue on Page 18 for the division's results. Besides brand management with remodeled administrative and commercial structures, we focused on cost-cutting and productivity initiatives, which ensured that our results were above the initial estimate. The EBITDA margin reached nearly 25% in the Fourth Quarter of 2020, an expressive high of 62% in adjusted and recurring EBITDA versus 2019. This is in comparable basis, considering the consolidation of the Cecrisa and Ceusa operations.

During the Fourth Quarter, we also launched our smart stores, as we showed during the last Duratex day. More details can be obtained in our video [ph] pages in our IR website. We'll continue our industrial modernizing program with some important steps still to be concluded in 2021. We now continue with our dissolving pulp project on Page 20.

We finished 2020 with the project within budget and within schedule, despite all the adversities to be faced. Besides being on an advanced stage, with our main negotiations concluded, it's important to remember that we concluded the funding capturing process to build a new plant in Minas Gerais. It came to a total value of USD 1.2 million. It was done with important international agencies, and it concluded the direct investment cycle with Duratex and Lenzing.

On Page 21, you'll see how this project is going. Here, you can see some pictures of the new unit. I'd like to highlight the special location that the plant has near forest, which is one of the main competitive edges of dissolving pulp operations. With over 4,000 employees on the front lines, we've concluded nearly 50% of the construction, which confirms our expectation to start operations in March 2022. We'd like to highlight the efficient pandemic management continuing -- which continues to work with the highest level of safety for all the frontline team.

Now on Page 22. Before we continue with our closing remarks, we'd just like to highlight the fact that 2020 was also extremely relevant in ESG for Duratex. With our first integrated report, we reinforced communication on our way of impacting the world through well-being impact and care. We managed to get some acknowledgments this year, we were nominated for the A list in CDP for the weather or the climate category. We are now in the S&P/B3 Brazil ESG index, along with the ISE B3 for the 13th year in a row. We were nominated as the most transparent company in the pulp and paper industry in the Americas according to the SPOTT program, and we were second place in leading corporate governance companies in Brazil in the ALAS20 yearly ranking. We know that we still have a long way to go, but we're happy with the results we presented in 2020.

So to conclude my presentation, we're going to continue on Page 23. When we think about 2021, we still see many uncertainties, but with the reduced interest rates, with civil construction so high, with consumers changing their behavior and paying more attention to their homes, we see a very favorable scenario for Duratex, even with the pressure we suffered in the last months. In the wood business, we continue in our strategy to have differentiated products, paying attention to price readjustments, considering the inflation pressures due to our dollar-denominated inputs.

In Deca, cost pressures have been surprising us negatively. But with price adjustments and with productivity activities such as ramping up the Recife ceramic lines, the second unit starting its operations in Kymab [ph] and with industrial automation projects, we expect to continue delivering results as demand continues to be strong. In Ceramic Tilings, we continue capturing synergies between the Ceusa and Portinari brands. We also started integrations with the Deca division, which will generate significant gains to our results throughout the year. With the dissolving pulp projects, as I presented, we continue to be on schedule. We have a confirmed budget, and we see that prices are improving in the dissolving pulp market, which favors this division's results with operations starting next year. We have a very positive horizon. We're very confident.

Thank you for the attention, and we will now continue with the questions-and-answer session.

Questions And Answers

Operator

(Operator Instructions) The first question comes from Carlos Greiner from BTG Pactual.

Q - Caio Greiner

I have a couple of questions. The first is on the demand for Duratex products overall. I think the entire market is having trouble understanding how demand is going to behave in 2021 after such a strong half of the year, which was the second half of 2020. You weren't in full steam across all of your divisions, a strong growth, and it seems like now we're trying to measure or at least understand how much of this will continue for the first and Second Quarters of this year. So can you give us any color, how much are you getting in terms of new orders? And how do you see demands at the consumers' end? We've seen that there still -- there's still a shortage of product and especially wood. So how do you see this happening in the market? And do you have any forecast for the Second Quarter? Can we say that the supply chain is normalized now? My second question is about capital allocation. We saw that you had a net debt of 1x. We're just wondering what your next strategies will be. So if Haddad could tell us what is the ideal leverage that you expect for the company? And if you have any updates in terms of capital allocation for 2021. So do you believe that M&A organic growth will be favored for your next steps? And if you're going to continue with your dividend policies for the next quarters before you have a clear growth plan that's approved by the Board. That's all.

A - Carlos Henrique Haddad {BIO 17599460 <GO>}

Caio, thank you for your question. So 2 different topics. So let me answer your question on demand. What I've been saying about demand is that we need to look at our local scenario, so the First Quarter. We have a positive outlook on the demand for our products overall. We're expecting that there will be a demand for civil construction materials in the next years. So I have a positive outlook for the next years. I think the macroeconomic scenario is favorable for us because interest rates will remain low. Even if they have some increase in May or June, even if it settles at the end of the Second Quarter, it's still going to be very low. So the trend according to all of our market indicators is for interest rates to be low around the world. So this will be extremely favorable to our business. The other thing is that people have been valuing their homes. People have been working from home, and we should not underestimate that. There is a strong growth in demand, and this should continue in the next years because it's not that we are going to go through -- get through the pandemic. Of course we're still going to deal with it for this year, but it's not for that fact that things will change. We see that people are now moving away from major urban areas. So this is very positive for us. This wave of new constructions that started in 2020 will continue in 2021. It will use in the next 2 or three years a lot of our products. So it takes 2 to three years to build an apartment building and will come in at the end of the process. So it seems like all of the stars are lining up for us for our wood panels division. I think it should continue to be that way in the next years. If we don't have any political turbulence in Brazil or any macroeconomic changes that affects everyone, we'll have a positive scenario. About the demand, it continues to be strong.

We don't have any -- we'll definitely have a great year in 2021, we expect to continue to grow. I think it will be a bit more stable. We don't expect stores to close again. So we expect that this year will be much better than 2020. So we still expect to improve, and demand continues to be strong across all divisions. We have some important strategies, not only for this month where we had a strong demand, but we also, in the First Quarter, had a great inventory. I think inventories are still going to take some time to normalize. I'm not sure if the -- if we can keep up with the demand that we will have this year. Of course with the pandemic, everyone learned to work with lower inventories. So I'm not sure if they will ever go back to the previous levels. But just to make up our inventories again it will still take some time. Of course we had a strong growth. So there are some bottlenecks, for example, in Deca, which are now being removed.

We continue to invest in expansion and activating some lines because we still have room to grow in our own inventory. We're not working with the ideal inventory levels that we should have. So that we can service our clients the best way possible. So I believe that in 2021, we will have a lot of demand still. The impact sometimes is not captured by the statistics, but it's important -- it's extremely important to mention construction and refurbishments. That probably represents 70% of our consumption. So this process will continue to be strong because there's the other effect of low interest rates, which is typical in Brazil. It might not be common in the U.S. Or Europe, but usually, when interests are low, people usually see, in construction, a form of investment. So there's a possibility, and this is still growing, of that happening. That's going to benefit our business. So in terms of demand for capital, we reached a debt level of nearly 1 this year, and we should continue to have a very low debt level. Of course we are always looking at different alternatives.

As you can see, we paid out dividends -- well, extraordinary dividends in this case, which was very positive. This year, we intend to -- well, 2020 was the year in which we contained our Capex. Throughout the pandemic, we didn't know what was going to happen. So in 2021, we will be stronger and normal CapEx in our operations. We have several small projects to remove bottlenecks. We have the new furnace in (inaudible). We are also removing some bottlenecks in the wood plants, which are starting this month. So our CapEx level is also higher. We are investing in some smaller businesses or some scale ups that make sense for our business, smaller things that add to our portfolio. So while we don't have any consolidated M&A projects, of course paying dividends is an option. That onetime debt-to-EBITDA ratio is very low. It will not be the ideal level. With the low interest rates, I think probably 2.5x or 3x is the ideal level. It could easily be that. But we have to leverage with the purpose.

Of course we need to have projects that make sense. Projects that are not outside of our reality. So we're working strongly on that. We have a specialized consultant helping us to define strategies, especially throughout the first half of the year. Our Board is very active. So inorganic growth is a possibility. There are some possibilities that -- some alternatives that we're analyzing, but the company, as you can see, is prepared to grow. We want to grow. Our view for 2021 is positive. So we don't expect to do anything just to leverage things for leveraging sakes. Things need to make sense. They need to be critic in our point of view. While we're waiting for opportunities, we will continue to take care of our cash. We are paying our debts. We have some opportunities to invest in removing bottlenecks, and this is what we're doing. We may have the option to have dividends. But of course our plan is to grow. So we're looking at opportunities there.

Q - Caio Greiner

If I could ask a follow-up question. You said the demand remains to be strong this quarter. So if you could give us some more information? Is that similar utilization levels that you reported in the Fourth Quarter, close to full capacity? Or will this be lower because of -- well, because of seasonal patterns?

A - Antonio Joaquim de Oliveira {BIO 15358831 <GO>}

Well we have to be careful about a couple of things. We expect to work at full capacity throughout the year. This is what we're doing. The First Quarter is following, of course a seasonal pattern. We have fewer working days. We have a lower demand for some areas. For Hydra and for the wood lines, we have some scheduled downtime, which reduces supply just as it does for all of our competitors. But our plan is to work at full capacity in all of our plants throughout the year. We don't expect to reduce that for now. This will definitely not happen in the First Quarter.

So we should operate at full capacity. But of course we have to be careful when we look at last year as a reference. There were some things from last year which are sustainable. For example, we have many of our costs avoided, and some of these costs will exist now. We had a CapEx project that was postponed, and it will continue -- it will exist now or maintenance time, which needs to be used now. So we can't keep the same cost level as we did last year, but we intend to work with the same margins. Margins, I think are stable. So as I said, we should have a full year, and we have positive expectations. For example, in our results, we expect to expand our results in 2021, but we need to be careful about cash generation. Cash generation last year was extraordinary. No company can convert BRL 1.1 billion in net cash. So this should not remain the same in the next cycle. We're not going to use capital in the same way. So it will probably be lower, but still be much better than expected. So our expectation is positive for the year, and we expect to continue to have a very strong pace this year. The only exception are the seasonal patterns that we see. We have inflation a bit higher, too. So we need to pay attention to that, but operations will remain at the same level.

Operator

Our next question comes from Marcio Farid from JPMorgan.

Q - Marcio Farid Filho {BIO 21476081 <GO>}

I have a couple of questions. First is about your price increase. So how much should we expect that for the First Quarter? And we see that you took some aggressive stances, which can reflect in a lower demand, especially in wood panels. We see, for example, that wood workers might have lost contracts with Deca, people might have migrated to lower value-added products. So are you seeing any changes in the market? Do you think that your demand could suffer from price increases? I'd also like to hear about your export strategy, especially for wood products. This is a market that is going to have much better margins. So will you continue to have an open door to the foreign market, considering, of course your profitability, not only now but in the future?

A - Antonio Joaquim de Oliveira {BIO 15358831 <GO>}

On prices, as you know, increases were posted. We had an uncommon year when it comes to price. We were pressured in our inputs by inflation. So we had a higher price throughout last year. Of course this year came, and we finished our budget in -- for 2021 in November. We expected an inflation. This year, we had above-average inflation. So you can see that prices went up in the First Quarter already. We had to increase our price in January, which is uncommon, but this has already been done. It's been announced. Orders were placed. Of course we're going to honor the orders that were already placed. But some of the price hikes, for example, were 15% in wood panels, 10% in Deca, 6% in Ceramic Tilings. So this would normally be postponed, but it was done to mitigate an important inflation effect that we're having. Inputs such as packaging, metal commodities went up, natural gas went up significantly. So this, of course affects our costs. I'd say that these increases will mitigate inflation for us. If we have any inputs becoming more expensive then we might need to adjust in the future. But I don't see that there is a lot of space for many -- of many significant price adjustments.

Price levels, I wouldn't say they are great. You -- we might not have recovered completely, but our price levels that match our profitability levels. So we need to follow this. We need to keep an eye on how inputs have been suffering from inflation. We need to work with what we have. The demand is high now. Of course if you need to adjust anything, you can, but that's not the first choice that we make. We need to be careful. Of course if prices go up significantly, you might have some elasticity, but not to the level we're seeing now. And again the price changes that we announced recently will still take some time to be captured. So they will only be captured by February or March. This is normal because it takes some time for the portfolio to be changed. So prices are offsetting our inflation. It's not the best word, but we are a little bit more comfortable with the situation.

We've seen some space to recover prices, which is not always possible. I don't believe that we will see significant adjustments in wood. The demand continues to be strong there, but there could be some elasticity. So if we work on the prices that are already being used, we have a good level. So I don't believe that demand will go up much more. If it is stable at that level, it's already strong. So for example, this year, we don't see any significant newcomers to the market, at least until the end of the year. We have one (inaudible) plant that will go online at the end of the year. But we already are considering it. So I do believe that prices will be maintained or corrected. Considering exports, we don't intend to stop exporting.

We understand that we are working with longer contracts. We're not exporting as much, but we do have important markets such as Colombia and the Indian [ph] countries, which give us a lot of profitability. So at this dollar level, especially for wood, our revenue is much better than in the domestic market or at least it's the same. So we intend to keep the same import to export balance. Most companies continue to export. We don't see any intention of bringing volumes in. A lot of people say that we could use the domestic market instead of exporting, but they have similar profitability levels. They're based on contracts. They're clients, just as the clients we have here. We usually honor many contracts. We try to maintain the market and we see exports as even at the level we are, which is not so high, we have a good balance. Other competitors have even better export levels, but we grew in this segment and we see a very solid demand in the U.S. In Europe and in many markets, a growing demand. Today we don't even have products to service this demand for exports.

Operator

The next question comes from Thiago from Bradesco.

Q - Thiago K. Lofiego {BIO 16359318 <GO>}

Antonio, can you hear me?

A - Antonio Joaquim de Oliveira {BIO 15358831 <GO>}

I think we have a technical issue here. I think we've lost contact with everyone. We can hear you. So do we have any questions? Well if there are no further questions, we can now continue with the closing remarks. Natasha, there must be questions. There must have been some technical issues because we can't hear them anymore. Thiago, do you have any questions? Can you hear me? I didn't hear Thiago's question. Can you hear me? Well we don't see any other questions. So if you can continue with your closing remarks. Okay. Let's just wait for a bit. Let's see if we don't have any questions.

Operator

No. There are no questions. No questions in the queue, Antonio.

A - Antonio Joaquim de Oliveira {BIO 15358831 <GO>}

Okay. So I would like to thank everyone for listening to our call. If you have any questions if you were unable to ask them, we can provide the answers through the Investor Relations team or directly with me. Thank you. Have a good afternoon.

Operator

This concludes Duratex conference call. Thank you for listening. Have a great day.