Q1 2013 Earnings Call

Company Participants

- Alvaro Penteado de Castro, Executive Financial and IR Manager

Other Participants

- Lucas Ferreira, Analyst
- Luis Vallarino, Analyst
- Thiago Lofiego, Analyst

Presentation

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 will conduct a question and answer session and instructions to participate will be given at that time. (Operator Instructions) As a reminder this conference is being recorded.

I would now like to turn the conference over to Mr. Alvaro Penteado de Castro, Executive Financial and IR Manager. Please, go ahead, sir.

Alvaro Penteado de Castro {BIO 5537843 <GO>}

Good morning, to my friends in Brazil and US. Good afternoon for those of you in Europe. It's my pleasure to conduct this First Quarter results conference.

I'd like to start in page number two, talking a little bit about some changes that took place in our corporate governance. Yesterday we held the shareholders annual assembly and this assembly voted for the new board of directors. With regard to the members, there was some changes. One member -- former member retired, (inaudible), and for his place, it was appointed Amaury Olson. Amaury Olson is a board members at Portobello and a former CEO and board member of Tigre. So he brings a lot of expertise in industrial -- with industrial background and the retail of building materials.

Also, our former CEO, Mr. Henri Penchas retired by age from the CEO position and was appointed as a board member. So as for yesterday on, Duratex now has 10 board members, three of which are independent and the two members from the (league and aside) four members -- five members from the (Itau) side.

The -- there was also appointed a new CEO, which we have released previously. His name is Antonio Joaquin, he is a former CEO of the Wood division and his background in the Company comes from the forestry management side. He is in the Company for 26 years already. So he has a deep knowledge not only in the industry, but on the Company as well.

Also, there was the existing committees were kept. We still have five committees, for of which are headed by board members named the audit and risk management, staff governance and nomination, sustainability and evaluation of related party transactions.

The fifth committee, the disclosure and trading committee led by (DIR) director.

Shifting gears to slide number three, let's start talk about results and during the First Quarter we posted some strong performance, some record numbers for the period, reminding that normally the First Quarter, seasonally speaking, is a weak quarter, but shipments came with strong growth in (debt), more than 8% growth in volume, reaching 6.5 million items a year -- items during the period, if we disregard the volumes of thermosystem and we felt still there was a growth close to 3% for shipment.

In the divisions growth in volumes were of 1.5%, reaching 613,000 cubic meters and just one comment here. If we revisit the year of 2012, we have such increases in that time. In April 2012, and December 2012 and these price increases, they kind of push more volumes to the First Quarter of '12, making it stronger in the Fourth Quarter of '12, making also stronger on a comparison basis to the First Quarter '13. So maybe this helps explaining why volumes came only 1.5% above what we posted a year ago, despite the strongness and the firmness of this market.

Net revenues on the other hand, expanded by almost 17% in the Deca division and 18.5% in the wood division. Of course on the back of more prices and a better sales mix specifically in the Deca division as we shift more MDP than MDF in the Wood division.

The EBITDA, just as recurring EBITDA, and there's a whole discussion about this terminology, further in this presentation, reached almost BRL280 million, this is a record for the period with markings at 32%. The recurrent return on equity reached almost 14% and during this period, we begin -- we begun the restructuring of Argentine subsidiary named Deca Piazza. We start the industrial production in that site, but we kept the brand and we are still carrying some revenues of products that we have there.

CapEx for the period is estimated at BRL660 million, roughly saying is a third for maintenance, both in the forestry area and the industrial site, a third for the Wood division and a third for Deca and these investments mostly to conclude ongoing investments named in the wood division, the conclusion of the new MDF line and they debottleneck (net) of the MDP facility in Taquari.

Both projects should start around June, July this year. And on the Deca side an expansion in metals and integration, the commissioning of a new ceramics plant in Rio de Janeiro, Queimados, which should start also more towards the end of this first half year, 2013.

Page number four, we have consolidated net revenues. Some highlights here again, net revenues expanding by 18% year on year and 17% on Deca. The big highlight here is the gross margin reaching 39.2%, almost 400 basis points above what we posted a quarter -- in the last quarter and almost 500 basis points above the gross margin posted First Quarter '12.

Why was that? Of course, Duratex brings some benefit. You'll know that the payroll in the Deca division specifically was benefited by being charged a 1% instead of 20% social charges as we had last year and we have also a marginal benefit in the cost of electric power. That also contribute for this margin on top of the price increases that we implemented both in the Wood division and Deca division. In Wood these price increases happened in June -- in January this year. And in Deca they took place in the end of last year.

With regard to the participation of the products and the composition of this -- the revenues, we -- it is important to note the participation of 2% that showers take place already in this -- in this revenue. Of course that we expect this participation to increase as we go deeper in this operation. Just to remind you, we acquire thermal system in January this year. So we started to consolidate this operation during the First Quarter this year? Okay. And it is already participating with 2% in revenues.

In the end, Deca represents 36% of revenues and the Wood division represents 64%.

Page number five, we have the EBITDA and for this quarter onwards, we will have some changes in the way that we calculate, reconsolidate this indicator. CVM, which is the local securities exchange commission, they released a norm saying how we have to build this indicator to standardize -- standardize it among the industries.

So what they're doing is viewed in the indicator as (basically as) earnings before interest, depreciation, and amortization. So to build up this indicator, we start with net income for the quarter, BRL148 million. We had income tax and social contribution, we add the net financial result and then we end up with the EBIT. After that, we add depreciation amortization and we get the BRL345 million with a margin of almost 40%.

Of course that given the characteristics of our operation, we -- we feel the desire to make some adjustment since there is -- there are some lines here, specifically the changing fair value of (inaudible) core assets and business combination among other adjustments, which are of a non cash base and we feel the obligation to discount those, to take them off this calculation, which we are doing here ending up with an EBITDA of adjusted for known cash advance of BRL300 million.

Specifically during this quarter and also during the Fourth Quarter, we have some extraordinary events, events that do not take place every time, they are not part of our operation -- ongoing operation, so we disregard them and then you have here in the footnote what they were for during the -- this First Quarter.

So we recognize the -- we had the reversion of the surplus coming from the defined benefits plan from our special funds, we have the reversion of this surplus in our numbers, and we also -- on the amount of BRL42 million, so this added up for the operational result and here we are taking this -- this effect off, and on the other way around, we also are adding up the expenses related to the discontinuation of the operations in Argentina, which would amounted to BRL18 million and we had our other BRL2.2 million, referring to other adjustments of extraordinary basis.

In the end, we ended up with a recurrent adjusted EBITDA of BRL278 million and an EBITDA margin of 32%. Record for the period, and the highlight here is that increase of almost 34% of the EBITDA year on year. First quarter, 12, this recurrent adjusted EBITDA was BRL208 million, so, an impressive operating improvement during this period, showing the consistency of the results, the good momentum that the Company is experiencing in both divisions.

Quarter on quarter, you know that normally the First Quarter is seasonally weaker, and specifically, last quarter the performance came off the charts much stronger than it usually gains actually last year Fourth Quarter seems pretty much in line with the Third Quarter, which shows a very unusual sort of performance and that explains the small reduction that we had in the EBITDA number of 2%.

All in all, if you want to check and compare the new way that we are disclosing the EBITDA with our former wage, we put the former way in the indexes of this presentation so you can find the old calculation on page 19.

Next slide, we have net income. We had a recurring net income of BRL140 million, posting a 25% -- sorry, a 63% growth year on year. Last year First Quarter, we posted BRL86 million and this year BRL140 million.

Return on equity increased from 9.2% to 13.7% even above the result from the Fourth Quarter '12, showing that the price increases (sticked), that the Company's clearly on a good momentum.

On the bottom, we have equity increasing by 10% year on year, reaching almost BRL4.2 billion and 3% quarter on quarter.

If we disregard and then you can find this information on the footnote. If we disregard all the investment that were made already and are not generating results yet, we can see that the return on equity would have been 14.7% during the First Quarter '13 on top of the 13.7%. So clearly, as we mature the investments and you know that we have a couple of investments almost ready in the Wood division and another one in Deca in ceramics as we mature this investment, we expect returns on equity to keep this base a -- increasing further.

On slide number seven, we have the performance of shipment in the domestic market of panels. On top we have the MDF market that had posted a growth rate of 14% a year during the last -- or since 2005. Specifically when we analyze the performance First

Quarter '12 and '13, we can see that there was an increase in shipments of MDF by 16% and on a quarterly basis a reduction that we credit that for the seasonality of the period. A decrease of almost 10%.

On MDP, volumes decreased on a yearly basis by 4% and by 3% on a quarterly basis. One comment here is that if you add that up, you will see that the market grew during this period by 6%. And on the following page, we will see that we Duratex posted a growth of only 1.5%.

The reason why is that because we land the price increase during this year, we were the first movers to push prices up anticipating the price increase that we expected to put in the market around April. So we anticipated, we pushed those prices increases in January on the back of the strongness of the market that we saw and we traded some market share during this period, knowing that the First Quarter normally and seasonally is weaker than the following quarters.

Slide number eight, we have the performance of Duratex itself. So here we can see that between 2011 and '12, volumes grew by 16% in our case and this year, year on year, only 1.5% as I commented before and a reduction quarter on quarter by 12%.

Below we have some occupancy rate. We can see that MDP ran at about 85%, MDF at 75%. Some comments, we had plant stoppages during this First Quarter and even during April and we will have some in May as well, and this explains partially the reasons why the occupancy rate decreased when compared to the Fourth Quarter. On top of that, of course, there was some trade in market shares via price increased.

The performance on slide number nine, still strong, firm, consistent. You can see that net revenues increased on a yearly basis by 18.5%. Again, gross margin played an important role in improving operating margins. They reached 39.4% on top of 35.3% the previous quarter and 31.5% a year ago.

Of course that these margins translate into operating margins, we can see that the EBITDA margin already adjusted and recurrent increased from 29.3% first year '12 to 36.9% first year '13, even above the 35.6% for Q12 that we posted last quarter.

These margins here, they are -- they are as good as the ones that we posted back in 2007. Of course that they have a lot to do also with this anticipation of (inaudible). So if the margins will be at the same level, it's difficult to say, especially because we have the start ups coming in the next three months or so, but for now, margins should stay on high levels.

Following to that, we start talking about Deca and the building industry. First about the ABRAMAT Index that measure the performance of revenues of companies of duty material companies. We can see here the evolution of performance of revenues and this index are -- that they compare year on year perform aces, so we start 2005 with this index decreasing by 4 -- 4.1% when compared to 2004, and so on.

In 2012,m this indicator increased by only 1% and just to remind you, revenues at Deca increased in the same period by almost 8% so we -- our performance was almost eight times the one for the industry. During the first Q '13 over the first Q '12 performance of the beauty in the industry was 1.7% up and revenues in Deca increased by almost 17% performance much more stronger than the rest of the industry and for the full year, the duty material industry expects revenues to increase by 4.5%. So far, Deca is beating this sort of performance.

Slide number 11 brings shipments, how was the performance of it in Deca, so again, volumes increased by almost 9% year on year, reaching 6.5 million items during this period. If we did regard the performance -- or the volumes of thermal system, this volume would have been something more close to 3% if I'm not mistaken. Occupancy rates during the period for metal ceilings around 80% and ceramics close to 90%. So the new plant in Queimados, we were riding a good momentum to provide more capacity for this business segment.

When we talk about performance, net revenues and EBITDA on page 12, we can see also a nominal and important improvement in gross -- gross -- in net revenues, I'm sorry, reaching to BRL350 million an almost 17% increase over the revenues of first Q '12. And gross margins recuperation there, we can see a quarter on quarter improvement from 35.7% for the Q12 to 38.9% first Q13. Of course that -- this improvement is on the back of price increases and some reduction on cost, the highlights year on cost is the reduction on the payroll, mostly given that in Deca labor is much more intensive than electric power. So this benefit is much more linked to labor reduction in cost of labor than in the reduction of costs for electric power.

Recurrent EBITDA and also, here we're talking about adjusted and recurrent, reached 23.7% in the quarter, on top of the 20.4% a quarter ago and when we analyzed the margins, year on year, of course that the evolution of costs during this period contributed to bringing margins a little down on top of the new businesses that we are consolidating already in the first Q '13, names (Metal) and thermosystem both were not existent first Q '12, so the comparison basis is not so linear, since these two businesses have lower margins.

Steal, we ended the quarter with pretty deleveraged capital structure, net debt over EBITDA -- EBITDA of last 12 months reached 1.35 times, just to remind you we left our -- in the end of 2012, this indicator was 1.34. So despite the increase in nominal terms of net debt to BRL1.5 billion, on top of BRL1.3 billion, still average is in line of what it was in the end of 2012 and lower than a year ago.

Part of the reduction of cash has to do with the payment we made for the acquisition of thermosystems and the payment of dividends that took place during the First Quarter this year and steal leverage is -- it's very okay for our standards.

Just to remind you, according to our policy --our debt policy, the cap in terms of net debt to EBITDA the ratio -- the cap ratio is three times.

The amortization schedule, we have this graph on the bottom. We can see that we have on cash, BRL857 million for compromise to BRL500 million still for the year of 2013, so, very comfortable cash situation, a pretty comfortable indebtedness situation. And for the following years, we have about almost BRL700 million of debt maturing both in 2014 and '15.

Following to debt, we have our CapEx, just to remind you the Wood division, I commented that already, but in MDF we are commissioning a new plant in the Itapetininga unit by June, July this year. It will be a 520,000 cubic meter per year capacity line which this year probably we will ship something around 120 -- 150,000 cubic meters, probably no more than that, giving the rough of process.

We are also finishing the debottleneck process of our MDP facility in Taquari, we are adding about 230,000 cubic meters extra capacity, of which, probably this year we won't be able to ship more than 100,000 given the same reason, under the ramp up of this debottleneck.

In Deca we are expanding or finishing the expansion of -- (in aptos) from 17 million to 18.2 million items a year, and again, we are concluding the investment in Queimados, which will increase capacity by 2.4 million items a year. Probably half of this capacity will be available this year and again, given the ramp up phase, possibility of an extra 500, 600,000 items a year of shipments, no more than that.

Why half the costs? We are commissioning only one tier of the second tier, probably will be fire only in the following year in 2014.

Below, we have a history of investments. So again, for this year the expectancy is to spend BRL660 million, we did already BRL170 million, and there is still BRL489 million for the year.

Following to that, slide 15, we have a history of capacity evolution. We can see that this year we will reach 2.2 million cubic meter capacity on top of the 1.6 that we had last year. We're talking about effective capacity. So again, not all this capacity will be available in the first momentum given the momentum we will start up the new capacity and the ramp up period. Again, probably this year an expansion of demand or availability of demand from the new line of MDF, only 120, 150,000 cubic meters, not this almost 600,000 that we see here.

In MDP, same reason, we are growing from 1.6 to 1.8, almost and there will be a ramp up from the debottleneckment that we are concluding Taquari.

In the bottom we have Deca and we are considering already in metal fittings both the capacities of (Mital) and here we are including or considering two shifts. Just to remind you, when we acquired this operation, it was running with only one shift of 780,000 per year, and we are considering two shifts already for this year and we expect that to happen during the second half of the year when the activity should be more demanded.

In sanitary ware, this expansion is basically the new plant of Queimados

Finally, next slide, we have the performance of both Duratex and the Ibovespa index. We outperformed the index by -- by almost 20% as we posted 6% valuation during the period as the Ibovespa index devalued by almost 20% -- 15%.

Market cap of the Company reached almost BRL9 billion, increasing by almost 42% when we compare to the market they have by the end of the first Q '12.

That was the presentation I had. The comments I had to make -- to make with you. Now, I put myself available for the questions that you may have. Thank you.

Questions And Answers

Operator

Ladies and gentlemen we will now begin the question and answer session. (Operator Instructions) Our first question comes from Mr. Thiago Lofiego with Merrill Lynch.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Hi. Good afternoon. Just a quick follow up from the Portuguese call. If you could give us some color on the cost evolution that you expect on the -- for the Wood panels business. You mentioned that you do expect some normal pressure going forward. But excluding the effect of the Itapetininga plant, what are the items that worry you the most, maybe reason or labor, if you could just give us some additional color.

A - Alvaro Penteado de Castro {BIO 5537843 <GO>}

Hi, Thiago, thank you for your question. Well as I said before, we anticipated the expected price increase for the year we anticipated to January instead of April. So because of that, of course, margins responded accordingly and that was the reason why we reached this record margin the Wood division almost 37%.

Looking forward, there's going to be a catch up of course -- of course, first coming from the labor side, you know that in Brazil our employees unionized and every year you have to renegotiate salary terms. And normally, when you see to negotiate with union, the demand is for inflation plus a real gain that normally is between one and 200 basis points above inflation.

So this looking forward should be the case. So if you're looking for an inflation around six -- 5.5%, 6%, you might expect labor costs to increase around 7% -- 7.5%. Which is the case and which is what we've been seeing the last negotiations.

The other input, actually we are not seeing much pressure coming from resin this year. In the very beginning of the year, we experienced some cost pressure coming from this input, but more towards the end of the quarter, the cost of resin decreased. It is a commodity, we have to wait and see what is going to happen. But we don't expect it to increase as it did back in 2008, it should behave more okay looking forward.

All the other inputs, we have to keep on eye, but they should increase in line or a little below inflation. In the end, or when we analyzed the full year, probably we will have a first half of higher margins and a second d half of lower margins on the back of cost pressure and start up costs. In the end, probably the margins will be pretty much inline of what we posted last year.

Q - Thiago Lofiego {BIO 16359318 <GO>}

All right. Thank you Alvaro.

Operator

Excuse me, our next question comes from Mr. Lucas Ferreira with JPMorgan.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Hi, Alvaro, thanks for the question. My question is related to the almost BRL80 million investment in working capital during the quarter. I understand that part of that is normal and according to the seasonality of the quarter because of the restocking. But I was not understanding that -- if there is anything let's say unusual in this working capital investment and if that could be reverted in the quarters going forward and if you could comment on this issue for the full year working capital, if there is room for -- I don't know, maybe reduction -- a reduction of working capital, or if this will potentially not be the case given the contribution of stocks etc for the new plant.

A - Alvaro Penteado de Castro {BIO 5537843 <GO>}

Hi, Lucas, thank you for your question. So the increase in working capital I think is more aligned with the inventory buildup following the price increase and the loss of market share that we had, or the trade of market share we had following the price increases that we implemented. Nothing else changed.

The terms are the same, receivables are still entering between 45 and 60 days, nothing changed in the -- on that front. Payables are around 30 days, nothing changed, so the only -- the only -- the only change or the only thing different than previous years is related to a price increase that took place in January in the Wood division and in Deca in December 2012. So because of that, probably we have some negative developments in revenue during the First Quarter this year and this is reflected in the inventory level that increased a little bit during the quarter, contributing for these -- half of these BRL80 million of working capital that you saw.

Possibly during the Second Quarter this number will reduce as our revenue starts to kick in.

Q - Lucas Ferreira {BIO 16552031 <GO>}

All right. Thank you.

A - Alvaro Penteado de Castro {BIO 5537843 <GO>}

You're welcome.

Operator

Excuse me, our next question comes from Mr. Luis Vallarino with Citibank.

Q - Luis Vallarino {BIO 15049752 <GO>}

Yes, hi Alvaro, thanks -- thanks so much for the call. Just a little -- if you could give a little bit more color on the cost control side, whatever you did during the quarter, not (inaudible) you had before.

And also, to confirm if there is in your mind still space for further price increases, maybe in '01, '02, during the rest of the year especially in Wood but also maybe for Deca? Thanks.

A - Alvaro Penteado de Castro {BIO 5537843 <GO>}

By the way, thank you for your question. Well as I said before, the price increases we anticipated. Okay? The demand came very strong in the Fourth Quarter and we took advantage of the performance of the -- the strong performance on the market to anticipate the expected movement more towards April. So we anticipated. We have to wait a little bit to see how the market will behave from now onwards.

If it comes in line with our budget expectation, probably there won't be more price increases. If we are surprised on the upper side with a stronger demand, a more robust demand environment, we might -- we might received that, we might re-discuss the issue internally. But on top of that, we have to see how inflation behaves on our -- on our costs. If we have some unusual cost pressure, something that we are not expecting in a strong market, of course, that we will go after that. But so far, it is pretty much it for the year 6% price adjustments for both Deca and Wood.

On the cost control side, you know that cost control is a daily activity in our business. We have internal commissions dedicated to study the operation and sometimes they come with minor adjustments. There's nothing too much off, too much odd in our operations, but I think there are things that can be done specifically when we talk about the new businesses that we acquire. We are still getting into this business.

I'm talking about Mitel and thermosystem, when we talk about Mitel, with the possible entrance of a second shift, there's going to be dilution of fixed costs, so margins will tend to improve normally with the addition of more people to run the existing equipment. When we talk about thermal system, you know that we have a clear focus to gain market share in this segment, the business is not very capital intensive.

So with minor investments, we can increase capacity quite fast and we will do so, but this is a business that we are entering. Again, we acquire it, we will finalize the position process in January, so we are still building up our knowledge on this business and seeing -- or getting a better understanding how we can improve margins in this segment.

And of course, when we ramp up this new equipment of ours and new -- these new plants of ours, there's going to be marginal dilution of fixed costs across the board.

Q - Luis Vallarino {BIO 15049752 <GO>}

Got it. Many thanks Alvaro.

A - Alvaro Penteado de Castro {BIO 5537843 <GO>}

Thank you.

Operator

Excuse me. (Operator Instructions) This concludes today's question and answer session. I would like to invite Mr. Alvaro to proceed with his closing statements. Please go ahead, sir.

A - Alvaro Penteado de Castro {BIO 5537843 <GO>}

Well thank you all for your time and patience. I put myself still available for eventual Q&A that you -- you have with my team, (inaudible) is helping me. We have (inaudible) also on the air. We are more than happy to assist you in case of need. Thank you, so much, bye bye.

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.