# Q2 2019 Earnings Call

## Company Participants

- Carlos Henrique Haddad, 'Chief Administrative Financial Officer and Director of IR'
- Marcelo Izzo, 'Vice President of Deca Business Unit'



## Other Participants

- Isabella Batalha Vasconcelos
- Renato Damaso Maruichi

## Presentation

### Operator

Good morning, and welcome to Duratex's Conference Call. We would like to remind you that this is being recorded. We are now going to turn the floor to Mr.Henrique Haddad, Investor Relations Director for Duratex SA Sir, you may go on.

### Carlos Henrique Haddad {BIO 17599460 <GO>}

Thank you.

Good morning, everyone, and thank you for listening in to another one of Duratex's quarterly earnings results. I'm here with Guilherme Silva, our Investor Relations Manager; and Marcelo Izzo, the Vice President for the Deca and Hydra Business. On Page 2, I'll start by reminding you of what happened over the last quarters. With the number of events and restructuring that we've gone through, it's important to make these impacts clear in order to facilitate how our results have evolve.

In the Deca division in the second quarter of last year, we sold first tranche of our forestry assets to Suzano. And the production and sales of wood fiber boards were still a part of our operation. As a reminder, this was sold to Eucatex in August 2018. Now for the Deca division during the closing of the second quarter of 2019, we announced that the Sao Leopoldo plant would be closed, which was a further step in optimizing our manufacturing park.



So with these events in mind, let's talk about our quarterly results. Going to Slide 3. Since the recovery of our national economy is below expectations, the second quarter of 2019 was marked by a sales volume below what was forecast, but with a well-managed commercial policy, which partially offset its negative effects. During this quarter, our net revenue was BRL1.1 billion, a reduction of 2% in comparison to the second quarter last year.

However, our pro forma net revenue was 3.1% higher than the second quarter of 2018. This was due to our commercial policy management and a better product mix. Adjusted and recurrent EBITDA in the company reduced by 3.1% in comparison to the same period in 2018 from BRL220 million to BRL213 million, and this was mainly impacted by smaller market volumes and increased costs. Recurrent net profits amounted to BRL69.5 million, with a positive impact due to the variation in biological assets and an improvement in our financial results.

Page 4 will discuss our quarter's cash flow. Overall, although we had initiatives ongoing, our cash generation is still below its potential, especially because of a decrease in our working capital since we had a lower number of sales and since our inventory is still high. It's worth highlighting that during this quarter, we had a disbursement of BRL47 million in the Ceusa expansion project where its production capacity will be double. This year, we've already dispersed around BRL45 million, and we expect to have an approximate expense of BRL35 million additionally.

Page 5 shows a little bit more detail. During this quarter, Duratex improved its cash cycle, closing at 101 days, a 6-day improvement over the last year. We have, as a positive highlight, an increase in the payment due dates for suppliers up to 9 days. Now our opportunity is our inventory average, although it's slightly better than the first quarter of 2019, it's still below what we expect.

The company's CapEx increased due to the effect of the one-off disbursements in the expansion of the Ceramic Tile units, as I said, which, if excluded, would show a reduction in comparison to the previous period. This confirms our commitment in managing assets without compromising long-term projects. Finally, as we said yesterday, we closed Cecrisa's acquisition, and it will be a part of our results from August 2019. Heavy disbursements for this acquisition were carried out as planned.

Page 6 will discuss the company's net debt. The company's net debt closed this quarter at BRL2,060 million, which represents a 2.45x leverage net debt over EBITDA, which is slightly higher than the last quarter, again, due to the CapEx used in expanding Ceramic Tiles. But we will continue toward in reducing leverage, which is one of our strategies on the long term. It's worth highlighting that still in the third quarter of 2019, we will receive the last tranche from Suzano at an approximate value of BRL375 million.

Another highlight for the second quarter was capturing the second issuance of simple debentures at the value of BRL1.2 billion with an expiry date of 7 years and at an interest rate of 108% of the CDI With that, we conclude the second quarter of 2019 with an average financial term of 3.4 years verses the term of 2.1 years at the end of the first quarter of 2018, and our costs are very competitive. This already is reflected in the significant reduction of our financial expenses in the quarter when compared to last year. Moving on to Slide 7. We'll be talking about our business units, starting with the Wood Division.

So impacted by the effects of the trucker strike in May 2018, the wood panel sector according to the IBA data had a 6% growth this quarter in the local demand for wood panels in comparison to the last year. MDP volumes were a highlight with an increase of 10%, while MDF increased by 3%. It's important to note that exports reduced by 12% in comparison to the second quarter of 2018. The volumes of MDP and MDF exported contracted by 7% and 15%, respectively.

And there was a reduction of 3% in comparison to the first quarter of 2019. The exported volumes of MDP dropped by 1% and MDF dropped by 4%. Although there was an improvement due to the seasonality and the overall positive trend in the macroeconomic scenario, the wood panels market is still challenging. Since we are still slowly recovering in our economy and since we have more competitiveness, our adjusted EBITDA for the Wood Division, excluding the effects for the wood board sales, were BRL140 million, which was affected by a smaller volume sold and an increase in costs.

The Wood Division increased its sold panel's volume by 3.4% in the second quarter of 2019 in comparison to the second quarter of 2018. And exported volumes, just as happen in the overall market, we exported around 20% less than the second quarter of 2018, and this is mostly due to the increase in international shipping costs. Regarding net revenue, if we exclude the wood board business, our increase in comparison to the second quarter of 2018 was 7.7% with a gross margin of 31.4%. This is due to the company's commercial policy.

Continuing on Slide 10, I'll talk about Deca. The Brazilian Association of Building Materials -- that there was a 6 -- 2.6% increase in invoicing in the building materials market. However, for 2019, this was reviewed, including the most recent economic indicators showing that the growth for the year will be 1.5% versus the 2.4% that was estimate at the end of last year. So the industry dropped in comparison to last month.

But when we compare it to the same month in 2018, it went up by 0.6%. So the 12-month aggregate is still positive at 1.5%, while the base segment is the main highlight, 2.3% higher. As you can see on Slide 11, as the national economy is recovering under what we expect, the Deca Division showed in the second quarter a contraction of 5.7% in its expedited volumes in comparison to the same quarter in 2018, a total of 6.4 million parts. On the other hand, regarding unit net revenue, it grew by 9.3%, a result of an effective commercial management and a better product mix.

If we disregard the impact of the Sao Leopoldo plant being close, we see once again an improvement in Deca's recurring gross margins. And this includes the capture of synergies in the integration that took place with Hydra. Another positive highlight was the adjusted recurring EBITDA of BRL63.7 million, an increase of 35% vis-a-vis the same period last year. The highest EBITDA margin in the last 12 months, 16.5%.

This is a consequence of another one of the company's steps in its growth strategy, seeking operational improvements, commercial efficiency and cost reduction. I'd like to reinforce the message that even in a very challenging market, our restructuring plan is continuing with several initiatives that are already showing their results. Page 13, we'll discuss Ceramic Tiles. On the ceramic tiles market, ANFACER, that is the National Association of Manufacturers of Ceramic Coverings, in the second quarter of 2019 had a sales volume of 194 million square meters, an increase of 3.4% vis-a-vis the same period in 2018.

In the domestic market, sales went up by 3.1% and exports grew by 5.2% in the same period. Page 14 shows the Ceramic Tiles Division performing above the market. It presented in the second quarter of 2019, a growth of 19% in sold volumes in comparison to 2018. Our highlights were direct actions and points of sale and the new ceramic lines presented at Expo Revestir last March.

Net revenue was BRL56.9 million this quarter, which is 24.7% higher than the second quarter of 2018. And this is especially due to a better product mix. Finally, adjusted and recurring EBITDA for the division in the second quarter was BRL10.7 million, a 12.3% increase in comparison to the same period last year. Although there was a nominal improvement, the EBITDA margin was impacted by increased costs in gas and by absorbing expense -- SG&A in this period.

We are still working to recover our EBITDA margins as well. Slide 15 is a communication. Yesterday, July 31, we signed the final documents to conclude the acquisition of Cecrisa Ceramic Tilings, and their results will be included in Duratex's earnings from today. Cecrisa has a production capacity of 20 million square meters per year in ceramic tilings.

And it's one of the biggest companies in this sector in Brazil. And it's positioned at the premium segment. It produces and sells products with the brands Cecrisa and Portinari. With this acquisition, as we said before, we hope to gradually capture synergies above BRL250 million, especially due to the reduction of SG&A and operational costs.

And I'd, once again, like to highlight that Ceusa and Cecrisa Portinari products have the same consumption journey and complementary portfolios to ours, which opens some space for synergies also in the distribution and of the relationship we have with our clients and distributors. By concluding this acquisition, besides significantly increasing our ceramic operations, we can extend our product and brands as a whole. So to conclude our presentation, the next page will discuss our expectations for the second quarter of 2019. Although the first quarter of 2019 had a smaller growth in the national economy than what we expected, we are moderately optimistic about the approval of the Brazilian pension reform at the House of Representatives, which will increase investments and make consumers more confident, even if this is gradual.

In the Wood Division, the commercial policy and our product differentiation strategy with high volumes in the second half of the year should leverage our results. In Deca, by focusing on our growth agenda, we managed to improve consistently our gross margins and our productivity. And this is the result of the time and effort we made in industrial efficiency. Over the year, we can expect this to continue growing.

In Ceramic tilings, in the second quarter, we hope to -- excuse me, in the second half of the year, we hope to consolidate our expansion that is already ongoing. And to ensure that the business will have a higher production capacity. And of course, we want to integrate the Cecrisa and Ceusa operations in our new unit. Finally, by obtaining a license for our soluble pulp project, we started our Earth moving and infrastructure works at the place where we will install the new plant.

The project is within schedule. And as soon as it starts building, we will keep you informed. This concludes the presentation, and we are now open for questions. Thank you.

(Question And Answer)



## Operator

(Operator Instructions) Our first question comes from Mr.Renato Maruichi from Santander Bank.

## Renato Damaso Maruichi {BIO 17847481 <GO>}

Good morning, everyone.I have a couple of questions. The first is about Deca.

Deca is going through a very good turnout, and it's even difficult to compare it to the previous period. So what measures do you think our analysts should follow as Deca is being restructured? That's my first question. If it's gross margins, cash costs or what you suggest? And my second question is about the debt amortization program that you're redesigning. You're around BRL600 million to BRL700 million in amortization per year.

How did you decide that level? Can you infer that the company's cash level should also be at around that amount in the medium and long term? That's my second question. And if I could ask a third, I'd like to ask about Ceusa. I know that a lot is going to happen in terms of integrating to Deca and cutting costs but I'm losing track of what the margin will be? Should we expect the EBITDA to be closer to 20%, as happened in the last 2 quarters? Or should it be closer to 25%, as happened in the last year? So what's the cruising speed for that? Thank you.



## Carlos Henrique Haddad {BIO 17599460 <GO>}

Hi, Renato.

This is Henrique. I'll start with your last question, and then Marcelo will talk about Deca. To talk about ceramic tiles, we are following up our profitability and our margins very closely. We expect to go back to the same standards we have last year.

That's our expectation. We did have some extraordinary events this year, which put some pressure on them, but we are feeling at ease that this is a seasonal effect, and the second half of the year should have more positive results. So we are moving towards similar levels to what we deliver last year. And the challenge is greater as Cecrisa is incorporated.

But this is a part of the plan, and this is where we're focusing our -- all of our efforts on. This is where we see opportunities for synergy, and we don't have any expectations of getting used to this level, quite the contrary actually. Regarding cash management and debt amortization, debt management, many events took place in the last 2 years, many. So it's hard to see what the standard reduction or increase will be.

And I'd even say that if you look at the leverage, the specific value of our net debt, we should operate Duratex with a leverage of about 1.5x to just over 2x, depending on where we are. If we're acquiring something, if there's an acquisition, it can go above 2x, but we won't have a single target, a single operating figure. This flexibility, in our point of view, is healthy. And this indicates that we have a very good capacity for financing.

We're not going to miss opportunity if the cost is worth it, but we don't want to go back to the levels we had in 2016 where we didn't have any growth, that might have been the worst moment in our history. So if we have any changes in the leverage. Our expectation is that this will be due to a good cause. Just as we see now, significantly lower expenses in comparison to last year, which shows that our management of that indebtedness is effective.

Now I'll let Marcelo speak, and he's going to talk about Deca.

## Marcelo Izzo

Hi, Renato. How are you doing? I'll keep in line with what I've been saying about how we can assess our strategical growth agenda since we have volume contractions and since it's difficult to generate what the pipeline is. I have no doubt, and this is an important step, that our strategy is base on logistical and operational efficiency.

And even in the back to basic concepts that I've been speaking about for a long time, this is at a 24-month time line. So we're halfway through that. Given that principle is receiving the most attention in our transformational process at Deca, I'd say that the 2 variables that are the most important in this journey, especially for the last -- for the first 24 months will be our price capacity, considering the importance that we have as a brand, the unit revenue per part sold, and the last one that makes this tangible will definitely be our gross margins. So this is the second consecutive month in which our gross margins have increase, and I'm sure that this trend will continue in the future.

I don't know if that answers your question.

## Renato Damaso Maruichi {BIO 17847481 <GO>}

Yeah, that was very clear. Thank you.

## Operator

Our next question comes from Thiago Lofiego from Bradesco.

## Isabella Batalha Vasconcelos {BIO 20566061 <GO>}

Hi. This is Isabella, actually. I'd just like to know if you have any short-term perspectives for the third quarter for the wood panels or wood board sector. And if you could tell us a bit more about what will happen in early 2020 so we can understand what the margins will be for that division.

Another question considering Cecrisa is, if you have a timing estimate to execute the synergies you will attain? That's my question. Thank you.

## Carlos Henrique Haddad {BIO 17599460 <GO>}

Good morning. So about the Wood Division, it's hard to estimate anything for next year.

We're still very far from that. What we are seeing overall is that as this first round of reforms are passed, although this is not conclusive, although there is still a cycle to be concluded for these pension reforms to go through, we naturally expect that this will be a positive wave. We're not working with any kind of major impact in volumes for the second half of the year, but But what we see as a potential is a slightly better second half than the ongoing trend for this year and this is natural because the second half of the year seasonably is better. So we see that as potential.

This should be reflected on better margins. So we will continue to focus in capturing these benefits. In the case of wood, many of the initiatives that are structuring were carried out recently. What we are focusing on is leveraging these benefits as the market reestablishes itself.

So that's my answer regarding the Wood Division. Now about Cecrisa, we have a very detailed plan on how we're going to capture synergies. Our focus from now on, our integration team is already in Criciuma starting the joint management effort. We have a 30-day plan, a 100-day plan, so we do expect, especially in terms of structure, to benefit on the short and middle term from these synergies.

But it is important to keep perspective that this project will continue until next year. Many synergies such as trade relationships, our clients, distribution, they are very sensitive points. They required a lot of attention, and we're going to do it carefully. What we are counting on is that this entire effort of managing Ceusa and making the team closer to the Ceramic Tile segment will make us more efficient in how we capture synergies with Cecrisa.

So we're very optimistic about this.

## Isabella Batalha Vasconcelos {BIO 20566061 <GO>}

That was very clear. Thank you.

## Operator

This concludes our questions-and-answer session.

We will now give the floor to Mr.Henrique Haddad for his closing remarks.

## Carlos Henrique Haddad {BIO 17599460 <GO>}

Once again, thank you for listening in. I hope that during the third quarter, we have good news again, especially about Cecrisa. Thank you, and have a good day.

## Operator

This concludes Duratex's conference call. Thank you for listening, and have a nice day.