

## Q3 2018 Earnings Call

### Company Participants

- Felipe Saraiva, Unknown
- Guilherme Setubal Souza E Silva, Executive Manager of IR

### Other Participants

- Isabella Batalha Vasconcelos, Research Analyst

### Presentation

#### Operator

Good morning, ladies and gentlemen. Welcome to the audio conference call of Duratex. Thank you for standing by. (Operator Instructions) 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. And thank you for joining us for the Third Quarter earnings call of Duratex. Felipe Saraiva, our IR Coordinator, is here with me. We will present the results for the Third Quarter. And later, we'll be available for the Q&A section. I'd like to invite you to turn to Page two where you will find the consolidated results and the highlights of this Third Quarter. Slide #2. There was a good performance overall in the Third Quarter. But there have been some positive highlights in the quarter and a few yellow flags that we are being addressed. In my opinion, one of the main highlight was the sharp increasing volumes for the wood business. A stronger demand and an increase in the market share have driven volumes for the division up by 25% with a positive impact on revenues. We can also point to the performance in the foreign market due to an increase in exports and a strong performance by our operation in Colombia.

The second tranche of the deal with Suzano Papel e Celulose has been reported in this Third Quarter. Although recurrent EBITDA and recurrent net profit don't include these results, it has an important impact on our P&L. Lastly, we continue to see some pressure on margins as the main cost of commodity have risen up. In addition, the BRL depreciation was harmful for the cost performance. The net revenue were BRL 1.5 billion in the Third Quarter. If you exclude the sale to Suzano, net revenues would be up 25% year-on-year. The recurrent EBITDA was BRL 210 million, which represents our EBITDA margins of 16.4%. This result is an increase of 2.3% year-on-year. The recurrent net profit was BRL 62 million, an improvement year-on-year. When you compare to the First Quarter and Second Quarter of the year, we double our net profit in this quarter.

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Now I invite you to turn to Page #3, where we talk about the debt and the free cash flow of the company. So right now, on the Slide #3, as you may see in this quarterly financial results, we continue to deliver a financial deleveraging of the company. On one hand, the current operations have been providing a strong cash flow. On the other hand, the consolidation of important sales of assets has been speeding this process. This combination has driven the company to generate higher free cash flow in the quarter. Regarding the net debt, we ended the quarter with BRL 1.9 billion, which represents a net debt-to-EBITDA ratio of 2.3x. This ratio is significantly better than the previous quarter. When you compare it to the Second Quarter, the ratio was 2.8x.

I would like also to highlight the partial collection of the second tranche of the deal with Suzano, which will be fully collected by the middle of next year, middle of 2019. Moreover, we had disbursement of the respective taxes regarding the second tranche. As a result of a lower leverage, we have already seen an improvement in the net financial results due to our lower interest expenses.

Now let's turn to Page #4 where I'd like to present the details of our working capital and CapEx of the company in this Third Quarter. So on Slide #2, we can see the chart regarding the working capital and the CapEx in this quarter. As I've been sharing with you, in the recent quarters, working capital is one of our main focus in our daily agenda. In the quarter, there has been an improvement of 22 days in our cash conversion cycle driven by efficiency in inventory management. Regarding CapEx, we invested BRL 109 million in the Third Quarter. Although the investment is greater than the same time last year, we are currently running below what we had planned for this year, the forecast for this year. It reinforces our commitment to cash generation and the investments continue to focus on the sustaining of the operations. Lastly, the majority of the investments in the Ceramic Tile Expansion will be disbursed next year since we negotiated it with the main suppliers in the project.

I'd like now to turn to Felipe, our IR Coordinator, who will go into the details of each business division and what is our strategy. Please, Felipe, go ahead.

## **Felipe Saraiva**

Thank you, Guilherme. Good morning, everyone. And thank you for joining us this morning. So our results for the Wood Division in the Third Quarter suggested the positive trend for wood panels industry in Brazil. We have been seeing an increasing demand since the beginning of this year. And during the quarter, we had a significant increase in sales. On the table at the right side of this presentation, you may see that the idle capacity of the industry this year is lower than the previous one due to a better level of demand in the local market, some gains in market share on a few lines of products. And also a good performance on our operations abroad through the increase of exports from Brazil and a good performance in Colombia local operations. Volumes in the quarter amounted 768,000 cubic meters. It represents a 25% increase compared to the same period last year. The driver for this growth of volumes was mainly low-end furniture. Therefore, we have noticed a deterioration on the mix of products. Net revenues were BRL 1 billion with a gross margin of 27.5%. It's important to mention here that the net revenues were impacted by the second tranche of the sale of biological assets to Suzano. So if we

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disregard this nonrecurring event, the growth of net revenues would be 25% in the quarter. Recurring EBITDA was BRL 136 million with an EBITDA margin of 16.7%. The main drivers that pressured margins in the quarter were the deterioration of the mix of products; the cost increase in raw materials, especially the ones that will be used to produce resin and paper; increase in freight costs as a consequence of the truck driver strikes in Brazil; and lastly, a lower income from sale of timber to third parties. We are talking about recurring sale of timber to third parties since nowadays we have a lower surplus of wood.

I would like now to turn to Page 6, where we'll present part of the Wood Division strategy in the long run. We usually say that differentiation is the key in Wood Division strategy. We have developed last year the customer committee, where we discuss with the commercial -- we discuss the commercial strategy with the main clients of both distribution channels that we operate: Retail and furniture manufacturing. The idea for the next years is to intensify these initiatives and get closer to these clients. Secondly, we are willing to intensify digital initiatives in the business. This year, for instance, we have launched the app, Marcenaria D. It's an app for carpenters. We already have more than 100,000 downloads for this app. In order to accelerate the product life cycle, we are launching new products on a higher speed than before. We usually had new products in every two years. And nowadays, we are currently working on new products every six months. That's a way that we have to try to differentiate our products. In addition, we are encouraging the higher stability in the furniture manufacturing chain. Basically, initiatives such as reducing lead time and providing a better service level should enable us to reduce the noise in the value chain for our furniture.

Following our corporate strategy, we continue working on Duratex Management System in order to improve productivity and be the benchmark of this industry in terms of production and logistic costs. For the next years, we are going to continue our export program. Nowadays, we willfully export something closer to 20% of total volumes. And we are willing to sustain this level for the future. Improving business intelligence is also part of this agenda to get the most from the new commercial policy. And expand the commercial execution in the business. And lastly, to consolidate the cultural transformation in the division. So those are the main challenges for our wood panels in the future.

I would like now to turn to Page 7, where we'll present Deca's financial figures. We see the Third Quarter for Deca as the beginning of the operations recovery after a slow first half of this year. In terms of top line, Deca achieved earnings on a good level of sales if you consider that the building material industry in Brazil is still struggling. ABRAMAT index, that is the main proxy for this industry, points to a growth of 1.5% for the year after a drop in demand for the past four years. We could increase sales to the level of 6.9 million itens in the quarter, which resulted in net revenues of BRL 407 million. Capacity utilization levels presented a recovery compared to the beginning of this year. And we are currently running at the level of 72% of capacity utilization. Although margins in Brazil are still pressured by the hike in cost of commodities and the BRL depreciation, we could see an improvement during the quarter. EBITDA in the quarter was BRL 59 million with an EBITDA margin of 14.6%. In our opinion, the trend in Deca -- the overall trend in Deca is positive. And as we capture the benefits of all initiatives that are ongoing in the division, we may see a better performance in the following quarters.

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Now I would like please to invite you to turn to Page 8. So after a deep revision of Deca's strategy, we have defined what we call internally as the growth strategical agenda. This agenda is based on 6 pillars: The first one is to improve industrial and logistic efficiency. As we announced last week, for instance, we are consolidating the electronic showers footprint in order to improve the overall business efficiency. There are a lot of initiatives ongoing and these might be one of the main priorities in our agenda for the next few years. Secondly, we are revisiting the way that we deal with innovation in Deca. Our target is to be more assertive in managing portfolio. The third pillar is to improve the business intelligence as a whole, bringing new tools and processes to support some strategic decisions. The fourth one is to improve commercial execution and be more efficient in capturing sales at the stores. One of the main challenge for Deca in the future is to create new source of revenues. I would say that exploring more in the most of this strong brand that we have. And lastly, to consolidate the cultural transformation and have the correct people on the correct roles.

I finished now my presentation on Deca. And invite you to turn to Page 9, where we'll present Ceramic Tile results.

So the Ceramic Tiles performance was one of the main highlights during this quarter. We noticed an increase in sales, especially by offsetting the negative impact we had last quarter due to the truck driver strikes. So if you remember, last quarter, the volumes in Ceramic Tiles were down. This division was the one that has struggled the most with the truck driver strikes in Brazil. We sold in this quarter 1.5 million square meters of Ceramic Tiles that lead us to a net revenue of BRL 55 million. The gross margin in the quarter was 39.6%. Our EBITDA in the division was BRL 14 million. This was the best operating result since the acquisition on the Fourth Quarter last year. EBITDA margin was 25.6%, a benchmark in the Ceramic Tiles industry. As you may see, Ceusa is currently running full at 9% (sic) (99%) capacity utilization level, while the industry average runs at 75% of capacity utilization.

Let's please turn to Page 10, where we'll present the growth horizon for Ceusa. So the main challenge for Ceusa in the short-term is to consolidate the capacity expansion that we have announced last quarter. So we are basically investing BRL 94 million in a brownfield project to increase capacity 83%. We should see this new capacity ramping up by the end of -- by second half of next year. Working on productivity and challenge our operations with the lean manufacturing methodology is also one of the targets we have in Ceusa. In addition, exploring all the benchmarks we have internally with Deca. We are willing to strengthen our relationship with clients and professionals from the civil construction industry. Following also our corporate strategy, we are implementing a digital cultural transformation in order to improve efficiency of this business. And lastly, with expansion, we are going to be able to complement our portfolio of solutions in Ceramic Tiles and to consolidate all the differentials we already have in our portfolio. I finished here my presentation. And I would like to invite Guilherme, again, to talk about culture. Please, Guilherme, go ahead.

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

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Thank you very much, Felipe. Please turn to Page #11 and the idea here is to discuss our cultural transformation. As you may see, we have a time line that describes what we have done in the past years regarding culture. It's worth mentioning that the cultural transformation has been key for our longer-term strategy. We believe that the new culture, in addition with our efficiency in management of the business is going to be key to upgrade the company to a greater level of performance. This journey of transformation, as we usually refer to the culture transformation internally, started in 2015, when we hired an adviser to assist us and develop an assessment of our organization. In 2016, we had established a collaborative way that represents our new culture. This change is being implemented across the company. And it has evolved from our training team to the board. In the second half of this year, we are deploying this new culture throughout Duratex engaging our workforce.

Last year, we invested in initiatives to strengthen the new culture and develop its attributes in our leadership. Furthermore, we are certified in assessment of great place to work that certifies workplace with a high trust culture. This year, we continue to invest in improving our leadership within the organization. In addition, we have deployed the project in Ceusa, our most recent acquisition. Great Place to Work has certified for the second year in a row that we have a high trust culture. There is still more to be done. But it seems that we are on the right path. Now please let's turn to Page #12, where I would like to briefly present our innovation project. So here in this slide, the idea is to discuss the innovation of the company and to show our current project in this area. As we have shared with you on a previous opportunity, we are investing more in technology and innovation to sustain the long-term growth of Duratex. This year, we have created Garagem Duratex. The translation would be Duratex Garage. This is a partnership with Endeavor and we have select 7 scale-ups, a more maturity stage of start-up, to accelerate their growth. Although there is no investment necessarily involved, our goal is to get closer to the innovation and entrepreneurial environment. In addition, the program is to -- supposed to support innovation throughout Duratex. We focus on scale-ups that could address 3 points: First one, construction and remodeling; second one, operating efficiency; and the last one, digital platform. There have been more than 300 application in the program that should last for the next seven months. Now I invite you to turn to the last page and the idea in this last slide is to discuss the priorities in our agenda in the short run. So Slide #13. We have shared with you our long-term approach for the business unit. But it's important also to focus on the short run. There are 4 points that I'd like to explore with you guys in this slide: First one, we continue focus on improving results of the current operations in the 3 divisions: Wood Division, Deca Division. And Ceramic Tiles division. Duratex Management System, DMS, will be key to this transformation. Secondly, we sold important assets this year in transactions with Suzano and Eucatex. Part of our team is dedicating efforts to consolidate this transaction. Third one, as we have announced previously, Duratex and Lenzing are dedicating efforts to build a DWP operation -- dissolving wood pulp -- in Minas Gerais state. The project is currently running on schedule. And we continue to focus on the implementation of this new build. When we have any update regarding this project, we'll let you know. Lastly, to consolidate the expansion in Ceramic Tiles that was announced last quarter. The project is on schedule. And we are working on acquiring all the equipment to build the operation. That's the end of my presentation. Felipe and I are available to answer any questions you may have. Thank you very much.

## Questions And Answers

### Operator

(Operator Instructions) Our first question comes from Isabella Vasconcelos, Bradesco BBI.

#### **Q - Isabella Batalha Vasconcelos** {BIO 20566061 <GO>}

I have a couple of questions on wood panels. You've gained market share over the last few months. And I just wanted to know, if you think, there is a real risk of new and existing players adopting a more aggressive pricing strategy to regain volumes in the short-term. And if that is indeed the case, what would Duratex strategy be? Then the second question on Deca. We've seen an increase in unrealized prices over the quarter. I believe Q2 announced price increases and a better product mix. And my question is, how do you see Deca's realized prices going forward? Should we continue to see an improvement on the back of a better sales mix or if there is room for other price initiatives in the near future?

#### **A - Felipe Saraiva**

Isabella. Good morning. Thank you for the question. This is Felipe speaking. So regarding your first question, we actually don't see risks of losing market share or risks of seeing any price discounts and so on in this industry. We believe that the average of our competitors might be running closer to 85% of capacity utilization. And we actually didn't see a shift from exports to the local market. So we believe Duratex is the one that is most prepared to capture these new volumes in the markets since there have been some capacity reductions from a few competitors in the quarter. Regarding your second question on Deca prices, we have implemented a price hike in the Second Quarter. It was 4% in the metal lines. And we don't see room until the end of the year for any adjustments like that for pulp price. We could see a better performance of net revenues per unit by the end of the year just because of any adjustments in mix, if we have a better mix of products. But actual increase in prices, this should be our story for the next year. I don't know, Guilherme, if you'd like to add any comments here.

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

No. I agree with Felipe. Basically, on the Deca division, I would say that our challenge is to - I mean, to improve, again, the mix of products, right? So I think the combination of a better price on metal fittings plus the better mix was responsible for this increasing the net revenue per unit and the idea is to maintain this level of better mix of products. And probably next year, maybe you have some -- we can see some room to increase price, again, in Deca. But only next year as Felipe said.

### Operator

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

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

Thank you very much, everyone, who listened the Duratex earnings call of the Third Quarter of this year. So Felipe, Ludimila and I, we are available to answer any new questions you may have, okay? Feel free to contact us, if necessary. Thank you very much.

## 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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