FINAL

Bloomberg Transcript

Q1 2019 Earnings Call

Company Participants

- Antonio Joaquim de Oliveira, Chief Executive Director
- Carlos Henrique Haddad, Chief Administrative & Financial Officer and Director
- Unidentified Speaker

Other Participants

- Antonio Heluany, Analyst
- Juan Tavarez, Analyst
- Renato Damaso Maruichi, Analyst
- Ricardo Alves, Analyst
- Thiago K. Lofiego, Analyst

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the conference call of Duratex. (Operator Instructions) As a reminder, this conference call is being recorded.

I would now like to turn the conference over to Mr. Henrique Haddad. IR officer of Duratex S.A. Please go ahead sir.

Carlos Henrique Haddad {BIO 17599460 <GO>}

Good day, everyone, and thank you for joining us for another Duratex quarterly earnings conference call. With me today are Antonio Joaquim, our CEO; Marcelo Luise [ph], who is responsible for Deca Hydra operation and our IR team. I will start my presentation on Slide 2 with a few highlights for the first quarter 2019.

The first quarter was marked by a domestic market falling below our expectations with sales volumes slightly lower than expected. However, with our ongoing consistent trade policy, which helped, offset lower volumes in addition to a number of actions to control costs and productivity, which equally helped us manage our profitability.

In the quarter, we had a net income of BRL 1.1 billion, up 6.6% over the same period of last year. It is important to highlight that in the first quarter, the company had extraordinary spending given the structuring of the DWP point and also following our long-term strategy. Still, in the comparison with the first quarter '18, freight expenses increased after the truckers' strike occurring in May of 2018 and remained at higher levels. Recurring

EBITDA in the first quarter ended in line with what was presented in the first quarter 2018 totaling BRL 179 million.

This result were just the extraordinary effect of BRL 120 million relative to the sale of land and forests. Recurring net income was BRL 19.3 million, down 37.5% compared to the prior year, impacted by an increase in the expenses previously mentioned, in addition to a variation in the fair value of biological assets when compared to the first quarter of last year. I'll now go to Slide 3 where I'll speak about cash and corporate debt.

As I said, even with the nonrecurring impact of general and administrative expenses and low volumes, the company's operating result remained stable compared to the first Q '18. The company's cash generation remains as a priority agenda. Despite an improvement compared to 2018, we saw a worsening in working capital given the recomposition of inventory so we could prepare to maintenance shutdowns prepared for the second quarter of 2019 and also given the lower volumes sold in the beginning of the year.

The company's net debt ended the quarter at BRL 2 billion, which means a net debt-over-EBITDA ratio of 2.38x, slightly higher than the level of the fourth quarter '18, increasing leverage found mainly from the payment of dividends and interest on equity amounting to BRL 286 million occurring in this quarter. Despite this occasional worsening, we remain with a very positive outlook in terms of debt management and monitoring the market to such opportunities to manage our liabilities, aiming to extend the debt tenor and seek more competitive costs such as the issuance of the debentures approved yesterday by our Board of Directors with an average tenor of 6 years and remuneration of 108% of CDI.

These funds will be used to manage our liabilities and reinforce our cash. We now go to Page 4, where I will give you more details on working capital and CapEx. The company's cash cycle ended the quarter at 106 days, stable year-over-year. The positive highlight was the improvement in suppliers' payment lead times, which improved consistently in the quarter with a 14% increase vis-a-vis the same period of 2018. Average days inventory outstanding increased to 108 days, much influenced by the effects mentioned before.

As with CapEx, we invested BRL 82 million in the first quarter, of which BRL 43 million were invested in the development of biological assets and BRL 39 million in managing projects. As mentioned previously, the focus of these investments remains in sustaining our operations, which reinforces our commitment to long-term results despite our efforts to minimize the pressure of investments on the company's cash. Please go to Slide 6 for details on our division starting with the Wood Division.

The wood panels market recorded a 1.1% growth in local demand in the first quarter '19 according to data published by IBA, the Brazilian tree industry. MDP and MDF volumes grew only 1.1% and 1%, respectively, with pressure on the overcapacity of the industry. The Wood result was marked by the successful implementation of the new pricing policy, mix improvement, mainly with increased sales of laminated MDF, and volumes slightly higher than those of the first quarter 2018, as we can see on Slide 7. Before we get into more details, it is worth remembering that in the first quarter '18, the company still operated a hardboard business sold to Eucatex on January -- in the end of January of last year.

Thus, in order to understand the year-over-year comparison for Wood, one needs to purge the effects of the hardboard line from the results. Net of this effect Duratex posted a 3% increase in the volume of wood panels sold, higher than the number posted by the market in the same period. Net revenue totaled BRL 678 million in the quarter, up 8% year-over-year. Excluding the effect of the sale of fiberboard from the net revenue, this growth would have been up 13%. Even with higher freight expenses, the Wood Division recorded a stable adjusted and recurring EBITDA compared to the same period of the prior year totaling BRL 126 million. Net of the effects of the sale of fiberboard, adjusted and recurring EBITDA was up almost 3% in the yearly comparison.

And for the adjusted and recurring EBITDA margins, the division ended the quarter with a slight dip compared to the prior year. Let's go to Slide 9 for an analysis of the Deca Division results. The Brazilian Association of the Materials and Construction Industry Brazilian Association for the Construction Materials Industry, ABRAMAT, recorded deflated sales of civil construction materials with an increase of 0.1% year-to-date. March stands out as the first month of this year in which the year-to-date result has turned positive with a significant increase of 5.1% compared to February.

Formal employment for this sector, however, despite the second consecutive fall of 0.3%, showed an increase in the last 12 months of 1.7% with the base sector being the main responsible factor, an increase of 2.6% for the previous 12 months. The association's expectation for 2019 remains at a growth of 2%. On the next slide, Slide 10, we'll speak about Deca's result. Deca started the year with volumes falling below the expectation but with better prices, better mix and productivity.

In March, the division started to show signs of recovery. We believe that by year-end, we'll see an improvement in market conditions. Deca Division showed a fall of 8.3% in volumes shipped compared to the same period in the previous year with a total of 5.8 million units shipped. This result is in line with the performance of the civil construction materials sector as a whole, as published by ABRAMAT.

On the other hand, as it relates to net income and unit net income, the division showed an increase of 4.3% and 13.8%, respectively, in the year-over-year comparison resulting from both implementation of price increases announced in the period and improvement in the product mix, also an improvement in productivity, which, added to price gain and mix improvement, explained a significant improvement in gross margin compared to the same period of 2018. I would also like to highlight a 2.4% reduction in selling expenses during the period.

This reduction reflects the company's important step forward in its strategic agenda to grow Deca, which focuses on operational improvements and cost reductions, among others. Deca's adjusted and recurring EBITDA was BRL 45.2 million in the first Q '19, while the adjusted and recurring EBITDA margin was 13%. This was all I had for Deca, and I now move on to Slide 11 to speak about Ceramic Tiles.

The Brazilian association of ceramic tiles and sanitary ware manufacturers, ANFACER, recorded a sales volume of 197 million square meters in the first quarter of the year, which represents a 4.3% increase in sales of the sector as compared to the same period of 2018. On Slide 13, before we talk about the results, I would like to mention that the Ceramic Tiles unit was impacted in this quarter by the ERP system deployment process, which had a direct impact on its results resulting from higher expenses and delay in the billing processes.

Deployment was successfully completed in the same quarter. The unit shipped 1.2 million square meters of ceramic tiles in the first quarter '19, down 1.5% vis-a-vis first quarter '18. Net revenue in turn ended the quarter at BRL 46.4 million, up 4.6% in the year-over-year comparison, thanks to the price increase policy and increase of new products. The division's consolidated EBITDA in the quarter was BRL 8.4 million with an EBITDA margin of 18%. If it weren't for the extraordinary effects impacting the results in the first quarter, Ceusa would be operating with margins higher than in 2018, which should happen in the coming months.

Moving on, we have some comments on the short-term expectations before we begin the Q&A session. As mentioned before, the first quarter of 2019 showed us lower recovery in the Brazilian economy than expected with higher unemployment rate and low consumer confidence directly impacting the company's potential to increase its sales volumes. On the other hand, price increases and a more favorable product mix with highlights across all our business units, in addition to effective cost management and productivity, expectation for the future, for the year is moderately optimistic.

In Wood, the price increase policy has been successfully implemented, and the product differentiation strategy has already proven its value with a better mix shown in the first quarter. Along the year as domestic demand recovers, we expect that the division will increase its sales volumes and will continue to reap the fruits of these initiatives. In the Deca division, with a focus on the strategic growth agenda, we saw consistent improvement in gross margin and productivity gains resulting from the time and effort we put into improving industrial efficiency and the logistics of our operations.

In 2019, we can expect to see more operational gains and better productivity. In Ceramic Tiles, after the ERP deployment, results are expected to return to the planned levels. In the second half of the year, we expect to consolidate the manufacturing expansion project to ensure greater production capacity for the business. Now to remind you that this is a 2-phase expansion.

Therefore, we should not have the whole capacity available this year. In the middle of the second quarter, we expect to start the ramp up of the new line. Lastly, we remain focused on fulfilling all conditions precedented to start building the new dissolving wood pulp plant. The project is on schedule. And as soon as we have more news on the start of construction, we will inform the market.

I end my presentation here, and we can start the Q&A session. Thank you.

Questions And Answers

Operator

(Operator Instructions) Our first question is from Thiago Lofiego, Bradesco BBI.

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

Good morning. I have Two questions. First has to do with the behavior of demand of wood panels in the coming quarters. More specifically, what do you expect for the second quarter? What is the growth expectation regarding volume along the coming quarters, as I said? Perhaps you can give us more color on a scenario with the pension reform approved and without the pension reform approved, the best and worst-case scenarios in your mind. And perhaps you could you give us some color regarding the pricing policy. My second question has to do with Deca.

We continue to see results under pressure. When do you expect the margins will go back to higher levels given the work you have been doing to optimize costs, optimize SKUs? I just want to understand where you are in the process and what evolution you expect in the future.

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

Thiago, this is Antonio Joaquim speaking. Let me speak a little about panels first. Effectively, what you saw in our results is that we had a first quarter '19 falling below everyone's expectations in the market. I think we're coping with all of the political uncertainties and the coming and going of the government, and this has really gotten in the way in terms of consumer client confidence.

The market gets edgy month after month. I was curious because, of course, we don't inform this, but we always compare with the prior year. So internally or domestically, the results have come according to our planning for the first quarter of 2019. In terms of the bottom line result, we actually exceeded what we had planned. We had expected a first quarter -- but when we ended December, we had the panels sector heating up, and we expected a more careful first quarter '19 after the new administration took over. So we expected things to hold a little.

I just returned from a trip with 50 clients in the Wood area. We spent a few days together. And in talking with them, we feel that everyone has positive expectations regarding a recovery. But these expectations were a little delayed.

We expected these positive events to start in the first quarter, but now the expectation is that we'll see some recovery in the second quarter and for the second half of the year. You see Thiago, it is too early. Here we're following the macroeconomic conditions of the country. So it's too soon for us to say that there will be a more solid recovery in the second half of the year. We have to wait and see. Considering the first quarter, we are not throwing in the towels regarding the results we have planned. Even yesterday, we were discussing the forecast for the rest of the year with our Board of Directors, and the forecast remains at the level planned. Yes.

We have seen there's a positive side to each. Of course, whenever the demand is a little weaker, we suffer. But there is a positive side to it, we have advanced in more noble areas of wood panels, the laminated panels. We have improved our share of wallet with that product with our major clients. We have been able to maintain good prices, working strongly with resale prices. In other words, we are getting the best result in-house considering the expected impact of reduced volumes. So we don't see signs that the demand is dropping. No.

The market is stable but stable at a slightly lower level than what we expected. So I myself expect that we will see a recovery more towards the end of June or in the beginning of the second half of the year. So we expect that -- but again, it's too soon. We have to wait and see what will happen. But we are working strongly on our mix of laminated products, and we are well prepared in-house. We're running only 4 plants with a higher utilization factor of these plants. And with that, we can control our costs quite well. Regarding Deca, again, this is the result of the market.

There are 2 sides to Deca. Indeed, we have a lower-than-expected volume, but we are quite optimistic with our internal initiatives. We've been working strongly on improving productivity, quality index, those KPIs which reflect our costs and productivity. To give you an idea. We have 2 important fronts now, work fronts. One, beginning with McKinsey in a very recent project to work on processes, process optimization. And we also have work with integration being done in the area of revenue management. In other words, we are working in-house very strongly.

We are convinced that the first results will start to appear. In fact, we see the market is a little down, but we feel that Deca is evolving. It is dropping less than the competitors, gaining a little market share. So this is what we are seeing. But indeed, the market is challenging. Every day, we get a slightly different number coming from the market regarding expected civil construction. I myself expect civil construction to grow above the Brazilian GDP because it dropped a lot.

So we see new launches, we see similar construction activity happening away from the large capitals. But we have to wait, and we have to monitor the situation. We are more focused on doing our homework, working in-house to be in the right position. If we do that and if -- so if the market was in scope, perhaps we will have some space for prices, particularly in Wood.

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

And if I can go back to the first question. You mentioned the end of June.

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

Thiago, I'm sorry, we can barely hear you. It's very muffled. The sound is muffled. Thiago, let's try again because we couldn't hear you very clearly.

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

Can you hear me now?

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

It's better.

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

I just wanted to go back to the first question. You mentioned a potential volume recovery of wood panels as of the second half of the year. Is there room for more price increases?

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

It is what I said before. We have a plan considering working with a price increase that we implemented in the first quarter just now. If there is a volume recovery, there might be room for some occasional price increase in one line or another. But we do not have a forecast to say, yes, we're going to have price increases. That is possible. If there's an opportunity, we'll pay attention to those. But it's just soon to say that we're going to have price increases. With this demand outlook, I would say that for the next 2 to 3 months, there's no room for price increase.

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

Thank you very much.

Operator

Our next question comes from Mr. Renato Maruichi with Santander.

Q - Renato Damaso Maruichi {BIO 17847481 <GO>}

Good day everyone I have a couple of questions. I have a couple of questions. First, I would like to explore the recurring margin of Ceusa. With IT integration, will we have a positive counterpart looking forward? So the EBITDA margin of Ceusa in the last 2 quarters was around 25%, 26%. So is there any room for improvement of this level of margin after this IT integration spending?

And how can Deca help drive Ceusa given that they have many convergent and similar businesses? And the second question, well, we see dissolving wood to pulp as G&A and something that will benefit the Wood, Deca and Ceramic Tiles division. This nonoperational -- these nonoperating expenses have a weight in the results of the units. So along the year, how many million reals should be the impact of operating expenses on the operational units? And what is the criteria to allocate expenses, considering Wood, Deca and Ceusa?

And if I may ask a third question focused on Deca. Some operating numbers of Deca remain very volatile, particularly volume, particularly comparing with some unlisted competitors of yours. The volume dropped 8% in this quarter in the yearly comparison. In this increasing unit revenue, how much is given to -- is resulting from mix? How much from real price increases? And looking forward, how do you intend to improve Deca's mix of products?

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

All right, there are many questions there. So let's take it in turns. First Ceusa, very quickly. Yes. This effect that you saw is absolutely a onetime of -- effect. We operated in April with the same margins that -- in which we will -- or we will operate in April and May at the same levels that we were operating before, and we expect to end the year with exactly the same margins that we had.

As Haddad explained, net of those extraordinary expenses -- you see this is a small operation in Duratex. And we had to put a little more money into that to integrate the software, the systems, et cetera, and that impacts the margin because the operation is very small. And so that this explains. Net of these expenses, it would be running at a higher margin. So we don't see any -- we don't have any negative expectations, anything different than what we had expected for Ceusa.

We are extremely positive about this operation actually. It is a onetime -- off margin result. And not only will it go back to prior levels in the coming quarters, but by year-end we expect to recover the business and end the year at the same prior levels. We don't expect to expand it because we were operating with a high margin. We will need other types of movement to increase the margin even further. Regarding what you said about Deca, yes, we dedicated a first strong year to getting to know the fields of business, trying to optimize it as much as possible.

And now we're adopting a number of initiatives to better explore the synergies between Ceusa and Deca. So the expectation for Ceusa is rather positive. And I ask you -- it is -- this was a quarter with extraordinary effects, but please include in your modeling that these are extraordinary effects because there's nothing in the radar that would change our expectations regarding Ceusa. Secondly, regarding pulp, we invested BRL 4 million so far in this process. I cannot really tell you how much more we will be investing until the end of the year. This really depends. We are in the middle of a licensing process. If the licensing process is approved early or if it takes longer, we will spend a little less or a little more. If it's approved early, we can include some expenses, bring forth some operations. If it is delayed, I mean, it's not something that we can control, we are fulfilling all the requirements of the regulatory authorities.

So we're not -- perhaps we can try to break it down later for you and to show the trend. Of course, we are not going to consolidate this in the balance sheet. But perhaps for your analysis, we can have a separate breakdown and show you the numbers and obviously their effects. Just one additional comment, it is important to remember that this event should happen only this year. If we have inflows of the 2 partners of the new company, then we will eliminate this kind of expense at Duratex, and then we will have a more pure vision even during the construction of the plant.

But we will be speaking more about that in the future. By November, if everything goes well, we should be incorporating the new company, then we would have the capital of flow. We are just awaiting the licenses to have it go ahead the green light, but there's nothing in the horizon pointing that the approval will not come. So we are optimistic about the project. And after that, we will have a capital flow.

So for the next 2 quarters, we will try to speak more about this in details. But until we get the license, we don't expect relevant investments. Relevant investments will come after approval. Regarding margins -- oh,Deca margins and revenues, Marcelo's here with us, Haddad is here, so we think that they can speak more about this. And if necessary, Renato will come back.

A - Unidentified Speaker

So let me try to remember the questions because there were many. There was one question regarding the composition of the unit price, how much comes from the mix, how much is the true price increase, right? The other question was a reduction in volumes, right? And the third one, I can't really remember. Could you remind me of the third question?

Q - Renato Damaso Maruichi {BIO 17847481 <GO>}

Of course. What is the strategy to improve Deca's mix looking forward? But this is a more strategic mid- to long-term question.

A - Unidentified Speaker

Okay. So let me speak about the quarterly results. Regarding unit prices, 70% of price realization is the price itself. 30% of the unit price comes from a mix improvement. So this is a straightforward answer to your question. Regarding volumes, yes, we believe that our volume is a little better than what happened to the competition.

And this was because of our market share in 2 of the main categories, metals and sanitary ware. We have a significant market share, which gives us safety that our strategic steps will reap the fruit, although we have a low generation in the top line with this volume. But we have been successful. Regarding a mix improvement, I believe that all of the future work in terms of innovation pipeline, it is all focused in optimizing our portfolio, both with an and internal and external perspective.

So we would have a reduction in our portfolio. Almost 30% of the portfolio was discontinued so that in the future, we can add complexity, a more relevant complexity, in more premium segments. And so in the long term, the trend is that more and more, the Deca portfolio will become more and more premium.

Q - Renato Damaso Maruichi {BIO 17847481 <GO>}

Thank you very much for the answers.

Operator

Our next question comes from Rafael Antonio with Morgan Stanley.

Q - Ricardo Alves {BIO 16840901 <GO>}

Well, Actually, it's Ricardo Alves speaking. I would like to insist on Deca if Marcelo's here with you. And you talked about mix and volume and helped a lot. But I would like to focus on the operational part, on costs, and try to understand what's happening. Perhaps you could elaborate in terms of metals and sanitary ware separately. I think it would help in terms of capacity. If you have any major issues regarding sanitary ware. If you -- what is your margin gain for the rest of the year.

In addition to a better mix and to prices maintained, perhaps we could have more operational gains coming perhaps from metals or sanitary ware. So that's my first question. And my second question is very quick about forest assets. We saw another sale. That was expected. It was relatively relevant. So I'd like an update from you. How do you see this? And what is your fit regarding forest assets? Are you comfortable or not? Can we expect any more deals for the rest of the year?

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

Do you want to answer the first question?

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

Before -- this is Henrique Haddad speaking. Regarding forest assets, this was a sale that was not included in the plan for the year. This is just complementing the package of sales to Suzano. So there was -- there's nothing more relevant expected for the rest of the year. We've been saying this over and over. We got to a base of forest assets which is compatible to our needs regarding production. So we don't have any significant plans to sell more in the coming quarters.

A - Unidentified Speaker

This is Marcelo speaking. Before I directly answer your question, I would like to repeat 2 phrases that Antonio said. He mentioned one thing which is fundamental from an internal perspective. Of course, you'll always look at an annualized comparison comparing with the prior quarter or the prior year. Of course, we have a plan for the quarters. He mentioned clearly that we are very much in keeping with our expectations. So what is the good news about Deca that I can give you?

Undoubtedly, regarding top line generation, particularly in the volume variable, we fell a little below the expected. So I think that market retraction was a little greater than what we expected. On the other hand, for the bottom line, in our EBITDA line item, it was just as planned. The question is how come we managed that. Basically, our whole productivity and operational efficiency plan is being executed. So you can see we had a gain in gross margin from 26.1% to 28.1%. In a quarterly -- in a year-over-year comparison, 2 percentage points of margin gain is quite significant in our operations.

So the trend looking forward is that we will continue with this scenario. Again, mentioned by Antonio of operating efficiency and productivity gains, this is the year when Deca will be focusing on one strategic pillar called operating efficiency. And this is our expectation, that more and more we'll have higher productivity, higher efficiency, fewer losses and higher operating quality.

Regarding the use of our capacity, it didn't really change much compared to last year. Once we are productive -- and this is a more and more important fact. Productivity has a direct relationship between minutes spent to produce a unit. The more productive I am, the more capacity I release for the operations, that this is part of the process.

So as I have higher productivity, we'll be improving and optimizing capacity. In a scenario for Deca, let's imagine that the volume doesn't grow. But the more productive and efficient I am, I will be releasing production capacity. So the main focus -- the take-home message regarding Deca is the recomposition of our gross margin.

Q - Ricardo Alves {BIO 16840901 <GO>}

Thank you.

Operator

Our next question comes from Mr. Juan Tavarez with Citi.

Q - Juan Tavarez {BIO 15083199 <GO>}

Hi good morning everyone. Just my first question is regarding the wood panel segment. I'm curious on your thoughts on, I guess, your initiatives on market share versus pricing in the current demand environment. What do you foresee is most important right now for your strategy? Is it holding market share as you're starting to see some excess capacity? Or is it really maintaining your prices on -- in wood panels?

And then second, maybe if you can touch on just overall sales mix within wood panels. What percentage of your -- those volumes would you, I guess, classify as value-added or laminated products? And what's your target for the remainder of the year within kind of like the sales mix view in wood panels?

A - Unidentified Speaker

All right. We -- your question on the wood panel segment is quite an open-ended question. So first one, we remain with a very intense focus on trying to maintain our margins and pricing. Regarding wood panels, we haven't been moving in market share. Actually, we've been gaining a little market share, particularly in the laminated wood panels, the high value-added products.

So we've been gaining market share there. And overall, we've maintained our market share. But our main focus would be to work to maintain our pricing. In a scenario, that would be a little bit more challenging volume-wise. We don't want pricing to deteriorate, and we've been successful in our endeavors in that sense. So we've been managing to maintain our prices, which is our priority focus.

Now if I understood your question correctly because the sound was cutting a little, you seem a little concerned about the percentage that we have of value-added laminated products compared to the rest. Well, we've been growing the percentage of laminated wood panels, and there's a plan to invest more and more in that.

Our goal is to have a better presence in laminated products. Currently, most of our production is laminated panels. We haven't got the numbers in the top of my head, but I think it's close to 65%, 70% of the total production. So that's already a growing share, particularly in MDF. So it is a company policy to continue to focus and to increase the share of laminated panels. And perhaps we can give up some participation in the rest of the products if we can gain more share in laminated products.

Q - Juan Tavarez {BIO 15083199 <GO>}

Apologies, my line dropped, so I'm not sure if these questions have already been asked. But I -- you were talking about the increase in demand in the second half of the year, and I'm wondering where you see that demand. If you see it in MDF or MDP coated. And I'm trying to understand the impact that the mix could potentially have on the margins.

So if there's any clarity that you could give us regarding the profitability between those products and your expectation for the mix going forward, it would be great. And my second question relates to working capital. There was an increase in inventory in the first quarter. And I understand that there are some maintenance downtimes and you're preparing for that. So is -- should we expect that these inventory levels return to sort of normalized levels later in the year? And does that mean that there should be a bit of a working capital release in the second half?

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

Thank you for the questions. Regarding the second half of year, traditionally the second half of the year is when we have a more heated demand. This is very traditional in the furniture market. And some client have used -- this was a little different. But last year, for instance, in the last quarter of the year, we had a higher demand. So yes, we do have an expectation that there will be some resumption of volumes. And regarding what we'll pick up -- unfortunately we're having sound cuts.

We can see that the retail segment is growing more strongly than the furniture segment. That works more specifically with MDP. So if an increase in demand indeed happens, we expect that there will be a better impact on mix using coated products and to supply the retail market. Regarding the non-coated products, such as MDP geared to furniture manufacturers, we expect a normalized level. If the market resumes growth, we expect it will resume growth for both processes. But effectively, what we see, what we expect is a better recovery in the retail market. It is a market that impacts more MDF. And also, you made a comment about inventory levels.

And Henrique Haddad can speak about its effect on working capital. But this was a decision that we made on purpose. In December, we had an inventory level which was rather low for Wood as a result of that accelerated demand in the end of the year. So we chose during the first quarter to produce as much as possible in our facilities even considering the demand retraction and to recover our inventory levels.

Our inventory levels are quite healthy in terms of quality. And this is first to prepare for the maintenance downtime that is expected. So we expect inventory levels will be normalized in the coming months. Henrique, do you have anything to add?

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

No. I just want to reinforce the message that we are very much focused on cash generation -- operational cash generation. In this moment, we have a slightly high inventory level, but this will be compensated in the coming months.

Q - Juan Tavarez {BIO 15083199 <GO>}

Okay. Thank you very much.Helpful.

Operator

Our next question is from Antonio Heluany with Bank of America.

Q - Antonio Heluany {BIO 20614129 <GO>}

Hello everyone. It's just a follow-up question on Wood. Antonio gave us a general overview, but perhaps you can comment on the competitive landscape. In the presentation, you mentioned that excess capacity is over 20%. And what about with the new entrants? And regarding price, you said you were successful in passing through price increases. I just want to have some color whether the competition followed you and what you expect looking forward.

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

Well, Antonio, here's what I can tell you. The new competitors in the market, while they have smaller operations, but the new entrants, given their circumstance was better than expected, we don't see any price wars. On the contrary, each player is looking for its own market. So Duratex has defended its market, maintaining the relevant market share.

We managed to implement a good price increase policy and strategy, and we don't see any competitor lowering prices. I mean, everyone is working according to their own possibilities. Each player -- every player has their own strategy and is running their business in the way they do. But with a market recovery -- if we think about the market recovery, prices remain very low compared to the past. So we should have an opportunity to recover prices compared to the sale of panels.

So I don't see a fierce competitive landscape or competitors lowering prices. I mean every player is following their own policy. And we see -- I would say that the competitive landscape is actually reasonable healthy. We don't see any wars.

Q - Antonio Heluany {BIO 20614129 <GO>}

Thank you.

Operator

This concludes today's question-and-answer session. I would like to invite Mr. Henrique Haddad for his closing statements. Please go ahead, sir.

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

Well, thank you very much, everyone, for participating and for your interest in our results. We expect to speak with you around the second quarter, and we expect to have you onboard in our conference call to discuss the second quarter '19 results.

Operator

That does conclude Duratex S.A. conference call for today. Thank you very much for your participation. Have a good day, and thank you for using Chorus Call.