

## Q2 2016 Earnings Call

### Company Participants

- Guilherme Setubal Souza e Silva

### Other Participants

- Jonathan Brandt
- Juan G. Tavaréz

## MANAGEMENT DISCUSSION SECTION

### 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. As a reminder, this conference is being recorded.

I would now like to turn the conference over to Mr. Guilherme Silva, Investor Relations Manager. Please go ahead, sir.

### Guilherme Setubal Souza e Silva {BIO 20114864 <GO>}

Good morning everybody. Thanks for joining in this Duratex conference call. The idea here is to discuss the results of the second quarter 2016.

First of all, let's turn to page number one, and the idea here is to discuss the highlights of the second quarter 2016. The highlight number one is regarding EBITDA margin, improvement of margins for both division. So as you can see, we had improvement in the Deca Division and the Wood Division in terms of EBITDA margin.

The highlight number two is regarding Deca Division, a record performance for electronic showers. As you know very well, we started this strategy to increase in the electronic shower business in 2012 when we bought Thermosystem and finally, we bought Corona last year, the second player in the market. We now have 30% of capacity share in this electronic shower business. And in the second quarter, the company had good performance in terms of sales and cash generation.

The highlight number three is regarding the Wood Division, increase of 23% in panel exports volume compared with the first quarter 2016 and 60% for the same period in 2015. So, I'd like to raise here that exports is a very important pillar of growth for the

company over the next years. So the idea is to reach the total of 30% of the revenues coming from out of Brazil through Tablemac plus exports.

So, on page number two, you have the consolidated net revenues of the company in the second quarter 2016. The net revenues consolidated in the second quarter 2016 were BRL 1.012 billion; the amount was at around 12% higher than the first quarter 2016 and below the breakdown per division. So the Wood Division Brazil, the net revenues were BRL 550 million; the Tablemac, the net revenues were BRL 116 million; and finally, in Deca Division, the net revenues were BRL 345 million.

In the pie chart below, you have the percentage per division. The Wood Division Brazil represented 54% of the revenues, Tablemac 12% of the revenues, and Deca represent 34% of the revenues. In the pie chart below, you have the relation between the internal market and foreign market. The internal market represent 80% of the revenues and the foreign market reached 20% of the revenues in the second quarter 2016. So, as I mentioned before, our strategy is to achieve 30% of our revenues coming from out of Brazil.

In the bar chart beside, you have the evolution of the foreign market over the total net revenues of the company. So, as you can see, since 2014, we are increasing our participation in the foreign markets.

So, right now, turn to next page, page number three and the idea here is to discuss the consolidated volumes, EBITDA margin and net profit of this second quarter 2016. So starting with Deca Division, the volume of Deca in the second quarter 2016 was at around 6.6 million items. This volume was at around 6% higher than the first quarter 2016. On the Wood Division, including Tablemac, the total volume was 613,000 cubic meters. This volume was at around 2% higher than the first quarter 2016.

So, regarding EBITDA, we can see a strong recover. So from BRL 160 million to BRL 172 million. The EBITDA increased 61.5% quarter-on-quarter.

Regarding margins, we can see the same recover. The margin in the first quarter 2016 was 11.8% and right now, in the second quarter 2016, the margin was 17%.

Regarding the net profit, in the first quarter 2016, we had a loss of BRL 30 million and right now, we revert to a small net profit of BRL 1 million, but that's important reversion in our trend in the net profit.

So, right now, please turn to page number four and the idea here is to discuss the Wood Division of Duratex, starting with the panel market in Brazil. The MDF market in the second quarter 2016 decreased 1.3% when you compare with the first quarter 2016. However, MDP had a different trend. MDP in the second quarter 2016 increased 10% when you compare with the volume of the first quarter 2016. It's important to mention here that the annual capacity on MDP increased from 4 million cubic meters per year to 4.2 million cubic meters per year due to Berneck (05:49) operation that start in the second quarter 2016.

So, please turn to next page, page number five and here, we'll talk about the operational performance of the Wood Division in the second quarter. The shipment in the second quarter 2016, including Tablemac, was 613,300 cubic meters. This volume was at around 9% higher than the same period of 2015. However, year-on-year, first half 2016 against first half 2015, the volume decreased at around 4.6%, but I would like to mention here that this decrease is in line with our expectation.

The table besides, we have the capacity utilization of Duratex in the second quarter 2016, including Itapetininga's plant. The MDF was 60%, MDP 58% and hardboard was 86%. In the average, the capacity utilization was 60%, a little bit higher than the first quarter 2016. But it's important to mention that if you exclude Itapetininga, the plant that should be down in the end of the last year, the capacity utilization reached at around 80%.

So turn to the last page regarding the Wood Division, page number six, and here, you have the financial highlights of the Wood Division in the second quarter 2016. The net revenues in the second quarter 2016 reached, including Tablemac, BRL 667 million. This amount is at around 9%, higher than the first quarter 2016 and at around 6% higher than the same period of 2015. Year-on-year, first half 2016 against first half 2015, the net revenue was quite the same, decreasing only 1.4%.

Regarding EBITDA, we can see a huge increase quarter-on-quarter. The EBITDA in the first quarter on the Wood Division was BRL 7.6 million (sic) [BRL 70.6 million] (07:59) and in this quarter, the EBITDA reached BRL 123.7 million, a increase of 75.2%. And we saw the same movement in the EBITDA margin. So, the EBITDA margin in the first quarter 2016 was 11.6% and in the second quarter 2016, the margin on the Wood Division reached 18.5%.

When you compare first semester 2016 against first semester 2015, the EBITDA in the Wood Division decreased 34%. In this first semester 2016, the total EBITDA in the Wood Division was close to BRL 200 million.

So, right now, please turn to next page, page number seven, and right now, we will discuss about Deca Division, okay. First of all, let's start on page seven with ABRAMAT index. The ABRAMAT index measures the net revenues of the building material in the internal market. In the first semester 2016, the ABRAMAT index decreased 14.3%, while Deca Division decreased only 5%. So, again, Deca is having a better performance than our competitors. What we can say in this case that probably Deca is gaining market share against our competitors.

So, page number eight, the operational performance of the company. Deca Division, the shipment in the second quarter 2016 was 6.6 million items, including Corona. This volume was at around 21.3% higher than the first quarter 2016. And year-on-year, when you compare first half 2015 against first half 2016, the volume decreased at around 6% year-on-year. But again, this is in line with our forecast for 2016.

In the table beside, you have the capacity utilization of Deca Division in the second quarter 2016. In the sanitary wares, the capacity utilization reached 59% and the metal

fittings, including electronic showers and normal showers, the capacity utilization reached 65%. And the average was 63% in the second quarter 2016, a little bit higher than the first quarter 2016.

Right now, please turn to the last page regarding Deca Division. Here, you have the financial highlights of the second quarter 2016. The net revenues of Deca Division in the second quarter 2016 was BRL 345 million. The net revenues was at around 18% higher than the first quarter 2016 and 3% higher than the same period of 2015. Year-on-year, as I said in the first slide about Deca, the net revenue decreased 5% this first semester 2016 against first semester 2015.

The bar chart beside, you have the EBITDA margins and the EBITDA of Deca in the second quarter 2016. EBITDA of Deca in the second quarter 2016 reached BRL 48 million. This EBITDA was 34% higher than the EBITDA in the first quarter 2016 and the margins increased from 12.2% to 13.9% in the second quarter. However, year-on-year, the EBITDA in this first semester 2016 decreased at around 34% when you compare with the same period of 2015. The EBITDA in this first half 2016 was BRL 83.6 million.

So, right now, please turn to page number 10. And for the next three page, the idea is to discuss the CapEx, the corporate debt, and the perspective for the company for the second half 2016. Regarding CapEx, our CapEx for this year probably will be at around BRL 486 million. This amount is including the tender offer of Tablemac that happened in the first quarter 2016.

In this first half, the total CapEx was BRL 255 million, basically BRL 100 million from the industrial CapEx, BRL 90 million was the forest CapEx and BRL 66 million was the tender offer of Tablemac. It's important to mention here that without Tablemac tender offer, the sustaining CapEx in this first semester 2016 was BRL 190 million below our initial expectation.

So, on page number 11, the idea here is to discuss the corporate debt of the company, and the main highlight of this slide is the reduction in the net debt in this second quarter 2016 against the first quarter 2016. The reduction of BRL 77 million, this shows the effort that the company is doing to improve our working capital. We mentioned this target the first time in the third quarter of 2015. We are working hard to improve our working capital and we can see this improvement in the second quarter 2016.

Regarding net debt/EBITDA, the relation increased a little bit from 2.95 times to 3 times net debt/EBITDA, basically due to a reduction in our EBITDA.

In the bar chart below, we have our amortization schedule starting with our cash position. Our cash position in the second quarter 2016 was BRL 1.3 billion, basically due to a bond that we issue in April 1. The amount was BRL 675 million. Given that, as we can see, we have enough cash to pay all of our debt that will expire in the second semester 2016, the whole year of 2017, and the majority of the debt that will expire in 2018. So, as we can see, we are in a comfortable situation regarding our debt that will expire over the next years.

In the pie chart beside, you have the composition of our debt. 70% of our debt is in domestic currency, basically BNDES loans and working capital. And 29% of our debt is in foreign currency, basically Resolution 4,121 swapped to BRL. So it's important to mention here that 100% of our debt is hedged to BRL. So we don't have any exposure in any other currency than BRL in Brazil and pesos Colombianos in Colombia. This is part of our hedge policies.

So finally, turn to the last page, page number 12. And here, the idea is to discuss the perspective for the second half 2016. Highlight number one is regarding the scenario. Forecast is for an improved economic scenario for - to the second semester 2016 basically for three reasons.

The first one, we are seeing an improvement in the consumer confidence index. The second one is regarding the inflation target. We are seeing some forecast to a reduction in the projection for the inflation. And finally, the last one is regarding the industrial output. The industrial output has been increased since April.

The highlight number two is regarding industry announcement of incentive measures for the construction material sector. The government last week announced some incentives for the civil construction segment.

So the highlight number three is regarding our internal agenda. So, as you know very well, we have two important projects ongoing, the Duratex Management System with Falconi Consulting more focused on variable cost and Zero Based Budget, OBZ, more focused in fixed cost. Both projects, they are going very well, right, so we are above our expectation. The results are above our targets, and we believe that we can see some good results for the second quarter 2016.

The highlight number four is regarding IT programs. So, we are doing some investment in IT and the idea is to do some optimization in the process, the improvement of service levels.

And finally, the last one is regarding our CapEx. I would like to reinforce the idea that our CapEx in the second semester 2016 will be restricted to the maintenance of the business.

So, that's it. Thanks for your time. And right now, we are available to answer the questions. Thank you.

## Q&A

### Operator

Ladies and gentlemen, we will now begin the question-and-answer session. Our first question comes from Jon Brandt, HSBC.

**Q - Jonathan Brandt** {BIO 17988091 <GO>}

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Hi. Good morning, Gui (17:31). Thanks for taking my questions. I guess both are sort of related to demand. First on Deca, if I remember correctly in the first quarter conference call, you said that there's about 800,000 units that were sold, but not shipped, and that we should see those in the second quarter.

So, I guess I was expecting second quarter volumes to be a little bit stronger because if we include those 800,000 units in the first quarter, volumes on a Q-on-Q basis would have been down. So, I guess I'm curious as to - if you're seeing underlying weakness in Deca or things are actually starting to pick up, and if we should see volumes in the Deca Division falling in the third quarter.

And then, secondly, I wanted to ask you on the working capital side. You've done a very good job on the receivables. But if I look in inventories, they continue to increase at least in terms of finished inventories.

So, I'm wondering if you can comment a little bit about are you running excess inventories. Is it really throughout all of your products? And if you could talk a little bit about sort of inventories throughout the entire chain, if - where we are, should we be seeing restocking or destocking throughout the chain? Thank you.

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

Just one second, Jon, please.

So, Jon, let's start with Deca's volumes. So, the new trend in Deca Division is to have the concentration of the volume in the last two days of the month, right? So, that's why we could recover part of our shipment in this quarter, but part of the shipment in the second quarter goes to the third quarter. But the idea is to recover part of that in the third quarter, and finally, in the last quarter that the sales stop in the middle of December to recover the wholesale over the year, okay? But there's a new trend in Deca Division that the volume is concentrated in the last two days instead of the last week what happened before.

Regarding the working capital, as I said before, we are working hard on this topic, right. So, we could achieve the targets regarding the extended tenor to pay the suppliers. So we are doing this hard job to extend the tenor to pay the suppliers. So with two sets in this second quarter, the idea is to improve more in the third quarter and the last quarter of 2016.

And regarding inventories, the idea is to reduce a little bit the inventories over the next quarters, but we believe that this level of inventories is under control for our strategy for the second semester. Okay. Thank you.

#### **Q - Jonathan Brandt** {BIO 17988091 <GO>}

Okay. So just to follow up on that, I mean, what about the entire system? I mean, do you have a sense of where inventories throughout the entire system from not only you, but

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also your clients? Are they well in kind of where they should be or do you think we should start to see some restocking here?

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

The point is the inventory in the – with our clients is still in a very low level, okay? So if you talk with our clients in the both divisions, in the industrial side and in the retail side, in the both divisions, in the both channels, the inventories are in a very low level. That's why we believe that if you see the recovery in the economy that probably will happen in the second semester, we can see a increase on volumes in the both divisions, in Wood and in Deca, but more focus in the Wood because the channel as a whole is with very low level of inventories.

**Q - Jonathan Brandt** {BIO 17988091 <GO>}

Okay. Great. Thank you.

**Operator**

Our next question comes from Juan Tavarez, Citigroup.

**Q - Juan G. Tavarez** {BIO 15083199 <GO>}

Hi. Thank you. Good morning everyone. So just to follow up on the inventory discussion, I'm curious how the end market demand is doing relative to the furniture side. So, you're mentioning that – I think you were saying that distributors don't have that much inventory in the chain, but are you seeing your customers get more demand?

I guess the key question I have is more the demand outlook into the second half of the year when we're seeing this new supply in wood panels entering the market. And if you can give me a little bit of color there on how sustainable is this demand trend you saw in the second quarter, where you got price increases into the coming quarters as new supply enters the market.

And then, second, if maybe you can give us – or reminder us what your sustainable CapEx is. Just to have that number. Thank you.

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

Okay. Okay. Regarding the first question, Juan, I mean since the end of last year, the level of inventories for the both channels, industrial side and the retail side, was in a very, very, very low level. We saw a small recover in the second quarter, right, but just a little bit, right. So it's not – it's even with this recovery in the second quarter in terms of sales, in the average, all of our clients are below the average of the last year's, okay?

And regarding the final demand, I mean, we are not seeing this recover so far, right. So the last client, the client that goes to the Casas Bahia and Magazine Luiza. However, what we can say here is that we are seeing some movements from the industrial that they are more willing to buy more panels in the second semester, okay?

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So, when we discuss the forecast for each client for the second semester, in the average, they are more optimistic to buy more panels than the first semester 2016. But, I mean, the visibility is very low. It's impossible to say that we will see a very big recover in the second semester. But in the average, we are more optimistic with the second semester than the first semester, okay?

The last question is regarding the CapEx. I mean, we believe that our sustaining CapEx will be below BRL 400 million, right. So, only to the sustaining of the business, okay? So, if without Tablemac, our CapEx in this first semester was BRL 109 million, right. So, when we believe that we can repeat maybe a little bit lower than that in the second semester 2016, we are very restricted to the CapEx only to the sustaining of the business, okay?

**Q - Juan G. Tavarez** {BIO 15083199 <GO>}

Okay. Thanks for that. Just to follow up on your first reply about the second half. Can you give us a sense of how you think about pricing versus volumes? So, if you do start to see some restocking across the chain and some better end market demand for wood panels, are you more willing to offer volume to the client or you want to try to stick to the this new level of pricing?

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

So, as you know, we did some price increase in the first semester 2016, right. So we believe that it will be enough for the demand that we are seeing in the short run, okay? So, probably, if you see a small recover in the economy as a whole, we will see a increase in terms of volumes. To increase price, we need to have more robust demand to see some room to increase price. So, to sum up, we are not seeing some visibility to increase price in the near future.

**Q - Juan G. Tavarez** {BIO 15083199 <GO>}

Okay. Thank you very much.

**Operator**

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

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

Thank you everybody to join in this conference call. I and my team, we are here to answer the new questions and we are available to (26:51) conference call and stuff like that, okay. Thank you very much.

**Operator**

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

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