

Q2 2021 Earnings Call

Company Participants

- Antonio de Oliveira, Duratex S.A.
- Carlos Haddad, Duratex S.A.

Other Participants

- Caio Greiner, Banco BTG Pactual S.A.
- Gabriel Galvão, Credit Suisse
- Isabella Vasconcelos, Banco Bradesco BBI S.A.
- Rafael Barcellos, Santander Investment Securities Inc.

Presentation

Operator

Ladies and gentlemen. thank you for waiting. Welcome to Dexco's Conference Call, where will -- we will be discussing its Second Quarter of 2021 Results. (Operator Instructions) Before we continue, we'd like to clarify that any statements made during this conference call about the company's business perspectives as well as projections and operational and financial goals are merely beliefs and assumptions from Dexco's Directors, based on currently available information.

Future remarks are not a performance guarantee they involve risks, uncertainties and assumptions because they refer to future events and therefore, depend on circumstances that may or may not come to pass.

Investors should understand that the general economy, industry conditions and other operational factors can affect the company's future results and lead to results that differ materially from those expressed in these forward-looking statements. Now, we'd like to pass the floor to Mr. Henrique Haddad, the Vice President of Administration, Finance and Investor Relations. Mr. Henrique, you may proceed.

Carlos Haddad {BIO 17599460 <GO>}

Thank you. Good morning, everyone. Welcome. Thank you for being with us for this conference call.

I'm here with Antonio Joaquim, our CEO; Glizia do Prado the ESG and People Head, Raul our New Head for the Wood Division and Marcelo Izzo, the Head of the Deca and Ceramic Tiling Divisions and we also have the Dexco Investor Relations team. This quarter

we are full of news as you saw during our Investor Day, but we are going to talk about the results for the Second Quarter first.

Lets start on Page 3. We finished the Second Quarter still had a high sales level confirming a very positive trend. We're at demand and operating in full steam and getting good results in implementing price hikes. As you can see in the evolution of our net revenue.

In the comparison with last year despite the atypical situation we have been due to the pandemic and with the previous quarter. By the way, when we look at our net revenue, we see that this is the highest level ever reached by the company.

With this evolution and a robust cost control we've been able unable to offset most of the input price hikes, which continues to be a daily challenge. This year we're strengthening negotiations and we're getting closer to our suppliers. China only we get the best prices but also to make sure that operations can carry on normally.

We finished the quarter with an adjusted and recurring EBITDA BRL 500 million. An evolution not only in comparison to last year but also in comparison to the previous quarter, but this result, this was the company's best half with an EBITDA of nearly BRL 1 billion. This result is higher than the entire result for 2019.

Moving on to our cash flow, we'll continue on Page 4. After record results in the last two quarters, we finished this half with a surprising results also in cash generation, which was BRL 381 million versus the BRL 50 million generation that we had during the same time last year, a conversion of 39% of our adjusted and recurring EBITDA in cash.

This was only possible due to efficient working capital management, which despite being consume slightly due to inventory buildup in some product lines resulted in a reduction of 64 days in the cash conversion cycle. This is a significant drop in the company's working capital needs from 25% to 12% in the last month.

Looking at the impact that this result had in our data level, we'll continue on Slide 5. The strong results have also been reflected in our reduced, which at the end of the quarter was at 0.9x net debt to EBITDA, which proves the company's financial solidity.

Another point I'd like to underscore is that some weeks ago, we got a tripe AAA rating BRA from fit, which proves the company's strong business position and it's proven capacity to generate cash even in adverse economic scenarios. We're very happy about this rating and it reinforces our financial health and it proves how we can execute our growth plan.

Now to talk a bit about our business divisions. Lets continue on Slide 7. According to IBA data, total wood panel sales were 2.314 million square meters, a 59% increase versus the same period last year. This reflected in an increase of 51% in MDF sales and nearly 76% in MDP. Volumes presented a 67% growth in the domestic market and 21% in the foreign market.

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Now looking at Dexco in this market, we continue on Page 8. The Wood division finished the Second Quarter of the year running at full steam after some program maintenance downtime. The division expedited 51% above the First Quarter of 2020.

This growth are strategic consistency and a price positioning and improving our mix where once again a highlight and took our adjusted and recurring EBITDA to 333 million during this period. For the year gains and increased prices and improved mix offset the costs and led our adjusted and recurring EBITDA to BRL 709 million with a 32% margin. This was a result that is unprecedented in this division.

Continue with Deca, we continue on Page 10. The macroeconomic scenarios do favorable for the several construction materials industry. According to ABRAMAT data there was an average increase of 38% in the industry versus the Second Quarter of 2020.

When we look at Deca on Page 11, after recovering from the seasonal sales during the last quarter, Deca presented a strong growth this quarter in it's sales volumes, which connected to increased prices and efficiency gains led to an above average growth and an average advance of 49% in it's deflated income versus at the same time in 2020.

These efforts were enough to offset the costs and inputs pressure taken during that time. With that, the divisions recurring and adjusted EBITDA came to a total of BRL 89 million more than twice then what we had in 2020 and 37% above the First Quarter 2021.

Deca's effort in perfecting it's commercial strategy and focusing on operational efficiency resulted in the 9th consecutive quarter in margin gains in a yearly comparison excluding the impacts from the pandemic last year. Over the year the adjusted and recurring EBITDA represented a BRL 154 million, 128% above the first half of 2020 with a margin of 15%.

Now about the ceramic tiles market, we'll continue on Page 13. The ceramic tiles market according to ANFACER data grew 33% this quarter and 36% this year so far. The industry's utilization levels finished this quarter at around 88% of installed capacity utilization maintaining these high levels.

For further details on ceramic tiles at Dexco we continue on Slide 14. The Ceramic Tiles Division finished the Second Quarter of the year with the strong growth in sales volumes above the market average. This has been boosted by successful launches in the industry fair March.

This was an event that also boosted the divisions unit revenues, which connected to the efficiency gains that we got from the synergy capturing process and integrating operations offset increased costs and took us to a growth of 43% in our EBITDA versus the First Quarter of 2021 and more than doubled it in comparison to the Second Quarter of 2020. During this half good results and effective cost controls took our adjusted and recurring EBITDA from the division to a BRL 134 million, a 26% margin.

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Now continuing with the dissolving pulp project, we move to Page 16. We finished one more quarter confirming the schedule for the construction work despite all of the adversities we face, with over 6,000 employees in the frontlines, we finished 75% of the construction, which confirms our expectation to start operations in March 2022.

We're confident about this initiatives potential to generate value. We'd like to highlight how efficient it was in managing the pandemic keeping working ongoing and maintaining safety for the entire team.

Now continuing on Page 17. We're proud to say that this quarter we once again were first place in SPOTT, which assess the -- which assess company's transparency level in the pulp wood, palm oil and rubber industries.

They assessed a 100 companies around the world in the pulp and wood industry and in 2021 we went up one position in the ranks reaching third place globally and we are leaders in companies in the Americas. We also got the highest rating in CDP in climate and we got B rating in water and forest. So that continues our ESG strategy.

So to conclude my presentation, we go to Page '18. On the 15th, we had Dexco Day, where we announced an investment of nearly BRL 2.5 billion. As you can see on the left-hand side graph, this amount will be disbursed over the next six years, with special focus on 2021, '22 and '23, without any relevant impact on the company's leverage.

Although these projects are very specific, what they have in common is that they're aiming to leverage the company's productive capacity and increase its operations. This is a very relevant point because in all projects, we intend to have higher returns than in our current operations.

We continue to be very positive in the markets where we work, especially with good perspectives in the civil construction industry. Thank you for your attention, and we'll now continue with the questions and answers.

Questions And Answers

Operator

We'll now begin the questions-and-answer session. (Operator Instructions) Caio Greiner from BTG Pactual, will ask the first question.

Q - Caio Greiner

I have two questions. The first is about your portfolio. I'd just like to know how that's going, how many orders are you getting in your different segments? And if you could give us a view of the Second Quarter, I imagine that now you understand it well.

And I'd like to know what your expectations are for the Fourth Quarter? Will the company continue to operate basically all of its lines at full steam. So are we expecting a similar result during the second half of the year?

For wood specifically, we understand that there was a downtime, but I'd just like to know if you're expecting the same volumes that you saw during the first half of the year. My second question is about your retail position.

Considering the announcements you made during Dexco Day. You announced an acquisition of a minority stake at BC. And you also announced a flagship store. I understand that this is still only a beginning, and you said that you don't want to compete with your clients.

But these small movements show maybe the company's future. So how do you see your position in retail, considering the middle term and considering physical and online stores? And what's your strategy for that segment? The company has been getting closer to consumers.

And I think that's been very clear in the market ever since last year when you announced your new strategical concept. We're seeing you getting some results from that. So how would that strategy of maybe going into retail aligned with your commercial strategy and focusing on clients?

And I'd also like to understand if your idea for your future stores is to make it as similar as possible as your flagship stores? Will we only sell Dexco products? Or would you have stores like BC has? And how will that be translated into incremental results for the company in the next years?

A - Carlos Haddad {BIO 17599460 <GO>}

Hi, Caio. Thank you for your question. So if we answer those two questions, we'll solve the company's strategical issues entirely but so to answer your question on the current orders. Orders are doing very well.

As you can imagine, since we are operating in full steam these orders have been very well managed. So it's very difficult to talk about this openly. We have a lot of demand, but each division is managing its own business. I would say that it's a very solid order portfolio.

We have a great level of orders for the second half of the year. So we have been managing it because we are going through a period in which inflation on inputs and goods is high.

And it's not totally predictable. So we have to manage orders as they come in because we do have some pressure on our prices. But we do have a solid list of orders and the entire chain seems to be on high demand.

So this is just to say that we expect to have a good second half of this year at the same pace as we've been seeing so far. So there are different projections, but we do expect for the second half to have the same occupation levels we have today.

As you noticed, we had some downtimes during the Second Quarter, some during the First Quarter too. So that means that we'll have more availability during the second half of the year.

But our perspective is really to run at full speed. And we'll give you some more information once we -- once we have them. For now, we have no intention of expanding our production because as we said, the projects we announced will still take some time to implement.

So just to make a long story short, we expect similar volumes for the second half of this year. And we do have some room to manage prices, but we also need to pay attention to inflation and manage that side of it as well for some inputs. But we expect a solid second half of the year for sure.

About the strategical point of some operations that we announced related to retail. A part of our strategy is to get closer to end consumers. This is going to allow us to understand their behavior very well.

This also helps us in building a better product portfolio, and it helps us in finding solutions for servicing them better and everything you already know. So getting closer to consumers is very important.

And it really is very strategic and very important for us. So you mentioned a couple of things. One was the investment we made in BC and the other one was our flagship store. We didn't announce flagship stores, floral.

We announced the decision to build one flagship store in Sao Paulo, which will replace the showrooms we have on Avenida Brasil, we have showrooms for Deca for Portinari. So we're building a completely new model. It's a project that we've been working on for a couple of years.

We're getting support from specialized consultancy companies. And at that location, we're going to have an exhibition, a better space for a discussion. It will be similar to a store, and we're going to have very modern concepts in retail. And we're not -- the goal for the store is not to have commercial operations.

Of course, it will have some so that we can work there. But we're still working on how it will be organized. If the concept of a flagship store according to its size and what we planned for Sao Paulo.

If it will be spread across Brazil, maybe it's a scalable model, then maybe we can have partnerships with some of our clients. I mean, that would be a good idea. We're working

on that, and we really want to be close to our clients, our partners and our retailers so that we can work on this flagship store.

So I just want to clarify that this is not connected to our BC operation. We see operation as part of our capital strategy. It just wasn't done with our fund because it would take up most of our funds.

So for other reasons, it was that outside of it. But the idea behind it is to follow-up on retailers, which is not a segment of specialized stores. It's a small retailer in smaller towns in the southeast of Brazil. That have brick-and-mortar stores, that have inventories, that work with sophisticated logistics and who service clients very well.

So we want to be closer to them and see that up close because that really is changing retail in these traditional construction material stores where Duratex itself or Dexco, and our brands were often not there.

So this is just a movement to follow-up on that. The results that this will bring? Well, it could be an option to expand maybe to have a greater participation, but we haven't defined anything yet.

So we want to follow two movements from up close. First, understanding retail, which we know we'll grow a lot there are many possibilities. Retail with lower inventories, with logistics, we want to be closer to that.

And we intend to do that through ADC. We really believe in this project. It's a very good company, and we believe that they have a bright future, and we want to be there with them. The second point is really being close and working together to -- with specialized stores at the high-end segment, where the strength of brands like Deca, Portinari and Ceusa and Duratex can really be known.

So these are two separate things, but that's the idea. We still don't know at what scale this will be you used a very good term. It's an option for the future, and we're investing on that right now. We believe that this is going to bear a lot of fruit that will bring the company great lessons as well.

Operator

Next question comes from Rafael Barcellos from Santander.

Q - Rafael Barcellos {BIO 20593721 <GO>}

Thank you for the results. My question is about the -- I just want to get a long-term view of the company. Dexco has been focusing on ceramic tilings and Deca. We've seen increased results from those segments, but we still see that the Wood Division and the dissolving pulp areas are still -- will be the most relevant ones for the company in the next years.

Besides that, the investment plan announced recently also is expecting some growth from that division. So how should we consider that mix between different business units on the long term? And how can the company increase its exposure in ceramics? Would that be through an M&A?

A - Antonio de Oliveira {BIO 17052717 <GO>}

Rafale, it's important to understand that the Wood Division is a very big one per se, it will not be reduced so that it will take up less of our business portfolio. The dissolving pulp project is very big. And there's nothing we can do there.

Of course, if you add up the LD project to our wood portfolio, then definitely, they will still continue to represent a huge share of the company just because of how big that business is.

If you look at the other side, one of the biggest growth drivers for the moment, and I'm talking here about the middle term. The next three years or four years has -- we make the investments we announced.

We're not focusing specifically in what. What we're investing in wood, and I'm not including the investments in LD because they have been made two years ago. They're different.

And from now on, we don't expect it will continue. I mean, this is a project that needs to mature and produce the results that we expect for our spreadsheet. So remember, in the past, LD was a very strategic initiative so that we could use some of our big assets in minigenes, which were idle. And it also provides us with some great balance because 100% of its revenues are dollar denominated. So that's one point.

The investment of BRL 500 million would most of it, about half of it actually has been made and we also have a consortium with (inaudible) So it's a very small investment for an auction that we will have in the future of working on something or having a project in the Northeast of Brazil or being able to sell projects.

I mean, we have several options. This is a very precious asset in the state of Alagoas and Pernambuco. And we want to have a solid four street basis around it. So this is our vision and this will allow us to decide us in the future. If you don't have a forest, you don't have a project, but the investment is very small when we look at everything we have today.

And the remaining are two investments, which will probably be the ones with highest returns in this entire package, debottlenecking, when you invest under a BRL 100 million you can add 300,000 meters to your production capacity. So this is an investment that pays itself back instantly, basically. It really is a very strong investment.

Another investment that is close to BRL 150 million or BRL 160 million is in ceramic tile lines, we want to increase our share of non-commodity products there. So we understand that this is a very positive investment.

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So out of the BRL 2.5 billion, we announced, BRL 2 billion were dedicated to investments that are not directly related to the wood operations. Their investments to Deca in ceramic tiles.

So it's split up into about three-thirds into different investments. So if you consider our future growth, where do we see the most possibilities, for example, if there's an inorganic possibility for growth, as Haddad said, our leverage is still not compromised by it. It's a very easy investment plan.

The biggest probability is that it will exist in this area of ceramic tiles or related businesses. We don't intend to expand our wood production capacity at least not on the short term.

So I'd just say that proportionately, the investments that we're making now, we'll focus on the ceramic side of the business. Of course, there are some investments in retail and so on. And that's the way forward for us, but the fact is that if I only look at wood panels, if I compare Duratex three years or four years ago to when I only have Deca and wood and wood represented 70% or only wood panels represented 70% of our business.

If you look at the same operation and how much it represents today of our portfolio, it really went down. But we created the LD project. So if you add up LD would, then, yes, it is still our biggest business. And we're very pleased right now with the results that we are getting from it.

Operator

Next question comes from Isabella Vasconcelos from Bradesco.

Q - Isabella Vasconcelos {BIO 20566061 <GO>}

I have two questions on my side. First, about wood costs. So there was a pressure this quarter due to maintenance downtime. So can you quantify what the impact of that was? I imagine that, that can improve your cost performance during the Third Quarter.

My question also is on investments. If you could give us some more color on the capacity ramp-up that you announced, especially Deca metals you had expected a 30% increase. So if you could tell us about when this capacity will come?

Is it linear? Is it going to start next year? Or are you expecting it for 2023 or 2024? That would be great. And you mentioned debottlenecking. So how much of that will impact your results?

A - Antonio de Oliveira {BIO 17052717 <GO>}

Isabella, regarding wood costs, we don't expect -- well, maintenance downtime are -- have always existed sometimes they vary. But according to their timing, right, but we

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usually have them in the first half of the year. Traditionally, the wood industry has a lower first half versus the second half. So that's why we always have.

We could have run at full steam, but you always have to stop every year. There are maintenance protocols for the equipment. And if you don't do it, you put your operation in risk. You might have stop, and that would lead to great losses. So it's not like maintaining a car.

You have some fatigue, some components need to be replaced and so on. So let me say this again. We had a lower volume, and we had the costs for the downtime in the second half, that's not what you're going to have.

You're going to have full volume, you don't really have any major downtime scheduled and we don't have anything new to say because we continue to be solid with prices versus costs. So we have good margins and costs will be monitored, but we don't expect any surprises.

So if you compare to the Second Quarter specifically, you're going to have a better performance because we're simply going to have more volumes. We don't have any facts that we can say are completely out of the curve about costs in the second half of the year, not at all.

So we expect to keep the same pace during the second half, but we expect also greater volumes because we won't have as many downtimes. So there's nothing new here. I can't say that I can expect a new cost.

Now to answer your second question. So you mentioned wood costs. Can you repeat your second question?

Q - Isabella Vasconcelos {BIO 20566061 <GO>}

Of course. I asked about your expected ramp-up in capacities that you announced?

A - Antonio de Oliveira {BIO 17052717 <GO>}

I remember. Isabella, I would suggest, well, obviously, we do have an expectation. There are some strategic aspects that we have. So for example, we have different situations in metals. We basically don't have much civil construction except for installing the equipment.

So as the equipment comes in, we have capacity additions, but there's also an issue of mix, what you'll produce. So it's not simple to -- it's not to simply say, consider 10% more in metals or 10% less.

In fact, you can talk to others to get an understanding of that, but there's a strategy behind where we're going to implement it and in what mix. We don't want to make that so transparent to the market and to our competitors, of course.

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With ceramics, it's different. So for example, we're considering installing two additional furnaces. So as they are installed, and this will be at the end of 2022 or early 2023. You're going to have added capacity for ceramic tiles, it was very clear that we have two lines in the Botucatu project.

We'll start with the first one, which will add about 150 million in capacity in 2023 in the next line in the future, a little bit more in the future. And that's going to depend on negotiations on how the line is expanded and so on.

There are still possible adjustments. We need to be careful about these projections because these investments favor two things, not only increased volumes, but they also favor the mix. So we're investing to expand capacity in more profitable segments of our portfolio.

Operator

The next question will be asked by Gabriel Galvão from Credit Suisse.

Q - Gabriel Galvão

Congratulations on your results, and thank you for getting my question. My first question would be a follow-up for Isabella's question. So you had mentioned Antonio, that it's very easy to model capacity increase given a certain CapEx to reach an NPV per share or the value that these projects generate.

Now when we talk about improved mix, you mentioned differentiation of wood products and Deca, that makes it a little more subjective when we look at these variables.

So I'd just like to know if you have any guidance for EBITDA and mix that might help us to make that calculation. And if you do, I'm not sure if you have any suggestions either, just so that we can do that.

So that's my first question. My second question is about M&A. Besides the expansion plan that you had already mentioned, your leverage is under one-time net debt to EBITDA. So do you believe that there will be any M&A opportunities in the future?

A - Antonio de Oliveira {BIO 17052717 <GO>}

I understand what you're saying, but it's not a very simple model really. I think actually our - our stuff has always been available if you want to check any models that you might suggest. But as I said, there are some components in these investments, which are very strategic.

So I can't tell you exactly what lines we're going to attack because that would be information that might help you make your projections better. It could also give some market information for our competitors.

What I can tell you is this, the projected growth above 30% in Decka and ceramic tiles is the number that we have been working on. And we also gave you a good idea of when these projects will be implemented, as I mentioned.

But I really would like to highlight that this can have an impact on the mix, on the average price. And that's a part of our strategy to -- I mean, really, it's not something that is ready to be shared. And I hope that you understand.

We really have to build our own strategy and our plan and our way of working in the market. So these are some points that are a little bit more sensitive, and I hope that you'll understand. Regarding M&A, is it possible to have an acquisitions. So from -- you understand that our leverage is low.

And as we said, these investments since they're taking place in the next three years, they're very easy, and they still leave our leverage at very low levels according to our projections.

So I'd say that our willingness, if there's an M&A possibility will remain the same. And our capacity of doing it is -- will also be. So what has been happening is well, M&A is not something that's so assertive as organic growth because M&A depends on opportunities, it depends on having a good fit. Some operations that you might question.

So for example, why instead of having an M&A operation or an acquisition, right, in the case of ceramic tiles? Why would you have a new plant? Well, as we said, we don't see in the market on what we want to grow into.

So that answers your question. We want to work on the mix on very high-end products, and there's a new competitor in the market that could be acquired and that represent exactly what we want. Or if they do have a part of what we want, we need to get along, many of the things we don't want.

So we had a very good study with a consultancy company, one of the biggest ones in the market. They worked with us during the first half of this year. And we met these opportunities very well. So the story about combining resources, right? Sometimes you have plans and ideas.

And right now, what we're seeing is that many assets are a little bit overpriced. So they might be overvalued, they're expensive because they're performing well. So we're being very careful. But we have a very clear answer for your question.

So yes. We are looking at all the opportunities, and we're able to make them. So this investment would be possible, and we could have a good level of leverage. So that's possible, there are possibilities to leverage some more in the market, and we're paying attention to it.

But we looked at several industries and several businesses, and we will consider M&As based on three points. They need to be aligned with our purpose. So they need to match our solutions in home decorations, it needs to fit into that world, right? Living environments, which is what we've been focusing on in Dexco.

We also want to see businesses that have good complementarity that can be to have synergies with us. And the third point is that they need to have a certain scale. So we can have smaller M&A operations, but we would want to add to our business, something that led us to a new business, but at a good scale.

We wouldn't go into a completely new business if it was too small. So that's the idea. So I apologize if that doesn't answer your question, Gabriel. I really can't say so much more, especially with the first part.

Q - Gabriel Galvão

No problem, Antonio.

Operator

As there are no further questions, we'd like to turn it over to Henrique Haddad for his closing remarks.

A - Carlos Haddad {BIO 17599460 <GO>}

Thank you, once again, everyone for listening. We're very proud to announce such positive results from Duratex or Dexco now, right? We're counting on you for the next quarter will be available for any questions you might have as we move forward this year. So thank you. We'll see you next time.

Operator

That concludes Dexco's Conference call. Thank you for listening. Have a good day.

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