Q1 2016 Earnings Call

Company Participants

- Guilherme S. Souza e Silva

Other Participants

- Juan G. Tavarez
- Karel Luketic

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

Guilherme S. Souza e Silva {BIO 20114864 <GO>}

Good morning, ladies and gentlemen. Thanks for following Duratex's first quarter results. My name is Guilherme Silva, and the idea here is to discuss the results of this first quarter 2016. First of all, it's important to mention that our results was impacted by the current scenario of the Brazilian economy.

Okay. So, please turn to page number 1, and here, we will discuss the highlights on this first quarter 2016. So, the highlight number one is regarding exports. So, increase of 80% in volume when compared to the same period in 2015. So, it's important to say here that to increase exports, it's part of our strategy to reduce the dependence of the domestic market. So, last year, we increased the volumes in 50%, and the idea for this year 2016 against 2015 is to increase the volumes more than 50% year-over-year.

So, the highlight number two is regarding Tablemac, our wood business in Colombia. So, the first one is regarding the excellent results from this subsidiary, right? So, in this first quarter 2016, we had a record in terms of volumes, EBITDA and margins in Colombia. And the second highlight is regarding a tender offer. So, a tender offer was made for the company's delisted. So, we had 80% of the shares, and right now, where we have 95% of the shares, we can say this company is delisted.

The highlight number three is regarding the bond issued. So, in this first quarter 2016, we issued a bond. The name is CRA, it's Certificate of Agribusiness Receivable. And the main highlight is the interest rate of this bond. So, the interest rate was 98% of the CDI. The amount was BRL 675 million. The total tenor will be six years. The principal will be paid in the end of this year. (02:42). And the interest rate will be paid in a semester basis.

And the last one is regarding price. So, on the Wood Division, increase in MDP price in March and MDF in April. In the Deca Division, a price increase of all portfolio to start in April. Later on, we will discuss this price increase in the (03:07).

And now, please turn to the next page, page number 2. And here, we will talk about the consolidated financial highlights. The consolidated net revenues of Duratex in this first quarter 2016 were at around BRL 900 million; found below, the breakdown per division. The Wood Division Brazil, the net revenue was BRL 500 million; in Tablemac at around BRL 100 million. And finally, in the Deca Division, the net revenue was at around BRL 300 million. Given that, the Wood Division Brazil represented 56% of the revenues; Tablemac, 12%; and Deca Division, 32%.

So, in the picture below, we can see the relation between domestic market and foreign market. So right now, foreign market achieved (4:00) 20% of our revenues. So this is important to emphasize, it's part of our strategy to increase the revenues that is coming from out of Brazil through Tablemac towards exports for you to have an idea. In the end of 2014, this relation was 90% towards domestic market and only 10% in the foreign market. Right now, we reached 20% and our goal is to achieve 30% of our revenues coming from out of Brazil over the next years.

So, please turn to next page, and here, we will talk about volumes, EBITDA and net profit. So starting with Colombia, the Wood Division of Duratex. So, as I said before, we had a record in terms of volumes. The volumes in this first quarter 2016 was 68,000 cubic meters. The EBITDA reached BRL 30.2 million. It's a new record. And the margins was 28.6%, right, so it's an excellent performance of Tablemac. We bought the company in 2012. After three years, right now, we can say that the company is having the performance that we expected before. Regarding the recurrent net profit, the net profit of Tablemac in this first quarter 2016 was BRL 12.6 million.

So, in the picture below, you have the consolidated volumes of both divisions, Deca and Wood Division. Starting with Deca, so here we can see we split the volumes in sales and shipment. Why? Because during this specific quarter, we had a big differential between the sales volume and shipment volume, right. So, as you can see here, in the fourth quarter 2015 and the first quarter 2015, the difference between the sales and shipment was very low, right? So the volume was quite the same. And right now, due to a big concentration of the sales in the last two days of the quarter, the last two days of March, so we had this difference between shipment and sales, right?

So, part of our sales we couldn't deliver in this quarter to the final client. That's why we can't consider it sales, but we can consider it shipment. And of course this affected our result in the first quarter because this difference, we are talking about 800,000 items will be – I mean, considering only in the second quarter 2016.

In the Wood Division, the volume increased from 595,000 cubic meters to at around 600,000 cubic meters, the increase of at around 1% quarter-over-quarter. When you compare to the first quarter 2015, the volumes decreased at around 15%. But it's important to say here that the first quarter 2015 was the main quarter in terms of volumes last year.

So we can tell you that (7:24) in this first quarter of 2016 was BRL 106 million. We had a big impact given the situation of Deca, the sales and shipment. We are talking about at around BRL 12 million. And the return to margins in this first quarter 2016 was 11.8%, and we had a negative net profit of BRL 30 million. So we are talking about a losses of about BRL 30 million. But it's important to mention that the majority of these losses was concentrated in January and February. In March, we had a better month in terms of financial results.

So, please turn to page number 4, and right now, we will start to talk about the Wood Division, okay? So, in this first slide, the idea is to discuss the panel market in Brazil as a whole, not only about Duratex, but about the panel market as a whole.

So, on MDF, year-over-year, first quarter 2015 against first quarter 2016, we are seeing a decrease of 8.5% year-over-year, first quarter 2015 against first quarter 2016. On MDP, we are seeing a decrease of 15% year-over-year when you compare the first quarter 2015 as with this first quarter 2016. But as I said before, the first quarter 2015 was the best quarter in terms of volumes in the Wood Division last year.

So, turning to page number 5, here we will discuss the operational highlights. So, as I said before, the shipment in this first quarter 2016 was 100 cubic meters to 1,000 cubic meters, a little bit higher than the volume in the last quarter 2015. Regarding the occupancy rate, the occupancy rate, considering Itapetininga's plant, reached 56% MDF, 61% in MDP, and 71% in hardboard. Without Itapetininga, the occupancy rate increased to 76%.

So turn to next page, page number 6, and here the idea is to show the financial highlights of the Wood Division in this first quarter. So, the net revenues in this first quarter 2016 was BRL 608 million. This result is 2.5% lower than the last quarter 2015. So, considering that we are increasing volumes, this decrease is regarding the price that in the average quarter-over-quarter reduced in the Wood Division.

So, regarding EBITDA, we had a huge decrease from BRL 137 million to BRL 70.6 million, basically because of very poor mix of product that we had in the first quarter, basically because we sold more MDP standard in January and February with very low price. So, in March, we had a different month with higher volumes, better mix of products. And as we increased price on MDP standard, we had a better average price in March given this action that we did in the end of February.

So, right now, please turn to next page, page number 7, and here, we start to discuss the Deca Division, okay? In this first slide, we have the ABRAMAT index. The ABRAMAT is a building material index of this sector as a whole. So, in this first quarter 2016, the ABRAMAT index was negative 17.3%. This measure the net revenues of the sector as a whole. As the net revenues of Deca decreased 13%, (11:29) we can say that, again, Deca is having a better performance over the average of the sector. So, what we can say is Deca is gaining market share over the last quarters.

Please turn to next page, page number 8. And here we can say that we can discuss the operational highlights of Deca in this quarter. So, the shipment in this first quarter 2016 was 5.4 million items. As I explained before, we have a big difference between the shipment and the sales, right, so considering only the sales, the performance of Deca in this first quarter 2016 was very close to the performance of Deca in the last quarter 2015.

In the picture beside, you have the occupancy rate. In the ceramics side, in the sanitary wares, the occupancy rate was 56%. In the metal fittings, the occupancy rate was 63%. So metals are including electronic showers, we believe that we'll increase this occupancy rate in the near future, next quarter, due to the seasonality of the winter, right? So, normally, electronic shower is one business that will sell more items during the wintertime.

Right now, please turn to the last page regarding Deca Division, right? So, let's talk about the financial highlight. So, the net revenues in this first quarter 2016, Deca Division, was BRL 293 million, right? So, considering the shipment, if you're considering the sales, the performance of the net revenue was the same of the last quarter 2015, BRL 330 million.

The EBITDA, we had the same situation. So, the current EBITDA increased first quarter 2016, considering only the shipment was BRL 35.7 million, right, without shipment. Considering only the sales performance, the EBITDA was the same of 2015 last quarter and the margin would be the same.

So, please turn to page number 10. In the next three page, we'll discuss CapEx, the corporate debt, and the actions that we are doing to face this tough scenario in Brazil. So starting to talk about the CapEx in page number 10. The CapEx in this first quarter 2016 was BRL 152 million, right, however, BRL 66 million was to do the tender offer of Tablemac. Without this extraordinary investment in Tablemac, the CapEx was at around BRL 86 million, half of that was concentrated in the plantation of the forest and the rest to the maintenance of the business.

Right. So, the company is doing a big effort to reduce our CapEx for this year. Initially, the idea is to have BRL 420 million only, the sustaining CapEx, and the idea is to reach one number lower than that.

So, next page, page number 11, here you have the corporate debt of the company. So, the first point, the net debt in this first quarter 2016 increased to BRL 2.1 billion, increase of BRL 237 million basically for two reasons. First one is regarding the investment in Tablemac, the tender offer in Tablemac that represents BRL 66 million and plus the payment of logistic fee that happened in the first quarter, right, and – but it's important to mention that part of that you refer to the cash of the company in April as a capital increase.

In the picture below, we have our amortization schedule. In our cash position in the end of the quarter, we had at around BRL 750 million. But it's important to mention that, since April 1, with the bond issue that happened in the first quarter, but we received the money only April 1, right now, we have more than BRL 1.4 billion in cash. So, we have our money, money to pay some (15:44) of our debt in 2016, 2017 and the majority of our debt in 2018. So we are very, very comfortable with our cash situation in relation with the debt that we need to pay, right?

However, the net debt to EBITDA increased to 2.3 times to 2.9 times basically for two reasons. The first one is regarding the increase of net debt and the second one is due to the reduction in our EBITDA, right? But it's important to mention here that we had a better performance in the first quarter 2016 as our expectation, and our forecast we believe that we can improve or increase our EBITDA. And with this as a consequence, we can reduce the net debt to EBITDA over the next quarters.

In the picture below – in the picture beside, we have the composition of our debt. So at around 60% of our debt are in domestic currency, basically BNDES loans, rural loans and working capital. 37% are in foreign currency, basically Resolution 4131, right, in U.S. dollar. However, as you know very well, 100% of this debt in U.S. dollar are (17:05) to BRL. So we took the loan and we closed the swap at the same time, so given that, we don't have any exposure in U.S. dollar in Duratex. And finally, 3.7% of the debt are in pesos Colombianos. This is due the Tablemac tender offer. So we increased our debt to do the investment in Tablemac.

So, finally, please turn to the last page, page number 12. And here, the idea is to discuss the main actions that we are doing in the year of 2016. The first one, as you know very well, we are very focused in our internal agenda. So, we have two big projects that are ongoing.

The first one is Duratex Management System is our Falconi project that started in 2014. And the second one, very important one, more focused in fixed cost, is Zero Based Budget, OBZ, that start in July 1. Both projects are doing very well, and we are achieving our targets. We believe that we can have a big sales in 2016 with these two projects, more concentrated in the second quarter and the third quarter 2016.

The action number two, we have two projects ongoing, the logistic products that we said in the last quarter 2015, right? So it's a project (18:38) with a consulting company to improve our logistic costs. The rest is a sales project and inventory management, this project that we are doing in our IT system.

So, action number three is a external market, is regarding exports. So, as you know very well, we are doing a big effort to increase exports since middle of 2014, right? So, we increased the volumes 2015 against 2014 in 50%, and the idea is to increase more 50% in 2016 against 2015, right? And as you know very well, basically, we are focused in Latin

America in three countries: Peru, Mexico and Colombia, plus United States. But it's important to mention here that we are exporting to more 50 countries nowadays.

Action number four is our CapEx. As I said in page number 10, our CapEx is restricted to the (19:42) CapEx for this year of 2016. And finally, the last work is regarding the capitalization. So, as you know, we did a temporary shutdown of the plant in Itapetininga in the end of last year, right, a reduction yet around 1,002,000 (20:05) cubic meters. We did (20:10) our production with the demand that we are seeing in the near future.

So, that's it. Thanks for your time. Right now, we are open to answer the questions.

Q&A

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. Our first question comes from Karel Luketic, Bank of America.

Q - Karel Luketic {BIO 16467278 <GO>}

Good morning, everyone. Thanks for the questions. My first question is actually on prices. So, you guys mentioned the price hikes initiative that you have been implementing on wood panel specifically both on MDF and MDP. And I would like to know how is the implementation and acceptance by clients and what level of impact to margins do you think is reasonable to assume we can see on the second quarter considering such price hikes and also a normalization of volumes?

And my second question, going into the volumes side is, what level of volumes are you seeing today and in the second quarter? And at what level should we expect it to run in this very short term compared to maybe second quarter of last year adjusted to export the base of the first quarter there? Those are my questions. Thank you.

A - Guilherme S. Souza e Silva {BIO 20114864 <GO>}

Thank you, Karel, for your question. So, regarding pricing, what we can say is the main reason to achieve this situation is a reduction in the production as a whole in the market. So, as you know, we shut down the plant in Itapetininga. We know that two of our competitors reduced their production in this year. So – and the situation is, given this low production as a whole and a lack of products in some specific segments, the industry as a whole could increase price. We are talking about between 10% and 15% in MDP standard, right, and at around 7% in MDF, right.

So, I think the main reason that we believe that we can maintain this level of price and maybe increase a little bit over the next quarter is regarding the level of production. We are not seeing increase in the demand, but we are seeing a reduction in the production as a whole in the whole industry, more focus in MDP than MDF, right. So, what we are seeing a lack of MDP in some days during the month, okay?

So, regarding your second question, last year, the first quarter had a very good performance in terms of volume and we saw a very (23:01) big level of anticipating of demand in March, right. So, we didn't see this situation in this year. Why? First of all, because the capacity of the industry to produce more in March was lower than last year. And the second point is all industries right now is operationally now at very low level of inventory, right. So we are not seeing a big demand or extra demand due to our price hike that happened in April. Okay?

But, of course, the visibility (23:37) is very low, right? So I can't say that the volumes will be very good. But so far in April, we had a good month in terms of volumes and pricing and mix, right? So, in May, what we can say this is our wallet, if I can say in this way, are doing in a good way, okay?

Q - Karel Luketic {BIO 16467278 <GO>}

That is perfect. Thank you very much.

Operator

Our next question comes from (24:09).

Yes. Good morning. My question is on leverage. You guys are pretty close to the covenant of 3.0 times, I think, is your lowest covenant. I was just wondering what you guys have so you could do if you've reached that covenant and if you think you are going to reach that in the next 12 months.

A - Guilherme S. Souza e Silva {BIO 20114864 <GO>}

Just one second, please. I mean, you are right. You are very close to 3 times EBITDA, net debt to EBITDA. However, if you analyze the month of March, the month of April and our forecast for the rest of the year, we believe that we can reduce the net debt to EBITDA from 3 times EBITDA to close – to lower than 2.5 times EBITDA, right? So we are, I mean, focused on that, right? So we know that we are not so leveraged, but we are in the – close to the maximum that you can have.

However, the free cash in the last month show us that the EBITDA will increase. We do believe that the net debt will increase so it can reduce the relation between net debt and EBITDA in the near future. But it's one point that we need to pay attention, and the whole management are focused on that.

Q - Operator

Thank you. And what would be the consequences of reaching that covenant? Are you guys already in talks with the debt holder, I think it's BNDES in this case?

A - Guilherme S. Souza e Silva {BIO 20114864 <GO>}

I mean, we had some – we have one agreement with the board that, of course, we can discuss to increase a little bit if necessary, but we don't believe that it will be necessary.

And regarding our debt, I mean, the majority of that is not linked to the covenants, okay, only a small part of that. But as I said before, we are very comfortable that this relation between net debt to EBITDA will reduce in the next quarter.

Q - Operator

Perfect. Thank you. And then a quick question on Deca and the price hikes that you guys were able – you announced in March and that are applicable in April. Do you think that caused the extra demand at the end of March that you weren't able to ship and thus you're seeing less demand in April ,or are you just seeing better demand in April regardless of what happened at the end of March?

A - Guilherme S. Souza e Silva {BIO 20114864 <GO>}

I mean, as a whole, what you're seeing that the home centers, the Deca clients as a whole, they are very low level of inventory, okay? So, of course, that we saw one – extra demand in March due to a price hike in April. But, I mean, a little bit higher than the usual, okay? So the point that everybody has a very low visibility, they have mostly (27:14) very low level of inventory.

Q - Operator

Perfect. Thank you.

Our next question comes from Juan Tavarez with Citigroup.

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

Hi. Thanks. Good morning, everyone. Just my first question, I just want to get a little bit of color on the movement in the mix that we saw both in the Wood Division and in Deca. I mean, if you can just give us some insights on what were the main drivers that have the mix change so much during January and February? And now what appears to be returning back to normal, like, what should we be paying attention to as indicators of the mix improving or deteriorating in your kind of your end market view?

And also in Deca as well, what do you expect going forward to be sure we (28:05) continue sell kind of the lower margin products as the economy remains in this kind of sluggish scenario? Or is there a room on the consumer side, let's say, an upgrade there on your product mix?

A - Guilherme S. Souza e Silva {BIO 20114864 <GO>}

Well, I mean, let's divide the quarter in two parts. The first part, January and the majority of February, we had a full mix or product on the Wood Division, okay, more concentrating in MDP standard. Why? Because some big magazines like Casas Bahia, Magazine Luiza, and Marabraz, for example, they are doing the re-composition of their inventory. Why? Because, normally, this kind of magazine sold a lot during the Christmastime and January, okay? It's a re-composition of their inventories.

That's why we had more focus in full mix of products, more MDP standard. Since middle of February and March, the retailers that in the first two months of the year didn't buy a lot, restart to buy, right. So it's a normal movement. So – and given that, we had a better mix of products in March. We are doing the same pace in April, right? But, of course, the visibility (29:31) is very low to say that this trend will happen for the rest of the year. But we can say it is – in the two months of the year, the mix was very poor, right, more focusing in – to sell to (29:53) industry and since middle of February, the mix is kind of better, more focused in the retail segment. But, I mean, the visibility (30:03) is very low. That's why we can say this trend will happen for the rest of the year.

And regarding Deca, I mean, in the first two months of the year, even though we had a full mix of product, the volume was very low, right? So, normally, in the beginning of the year, the home centers, the main client of Deca, and they're all builders, I mean, normally, the volumes are very low, right? So, since March, we are seeing a better mix in Deca too with a positive effect in the result since April with the new price.

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

Okay. Great. And maybe if you can give us some insights on just the trend in the working capital and also CapEx, how do you guys expect that to evolve over the coming quarters? I know you mentioned CapEx is going to be lower this year. I'm also curious on that new CapEx level for maintenance. Will you need to increase that significantly if you would improve your operating rates or is that sustainable for an extended period of time without significant investments in production?

A - Guilherme S. Souza e Silva {BIO 20114864 <GO>}

Just one second (31:18). So, regarding the working capital, due to the current scenario in the economy right now, well, we increased a little bit our receivable size. Okay? So (31:33) to the clients Brazil, we increased a little bit the tenor to receivable from the client, okay?

What we are doing in the other side is to increase the tenor to pay the suppliers, right, and to reduce the inventory for the minimum, okay? So we are working with a very low level of inventories that we can do right now. And, of course, we are doing a big effort to reduce the tenor to receive from the client, but you know that, in the near future, it's not reasonable, right? That's why we are focused more to increase the tenor to pay the suppliers, and, of course, to reduce inventory to the minimum. Okay?

So, regarding CapEx, if you do the breakdown in this first quarter 2016, the total CapEx was at around BRL 152 million, right? BRL 66 million was focused to do the tender offer of Tablemac. So in the sustaining CapEx, we had only BRL 86 million this quarter. Half of that is the plantation of the forest and the rest, BRL 33 million, is to do the maintenance CapEx on the industrial side. So, as I said in the call (32:48), we are doing a big effort to reduce the CapEx to maybe close to BRL 400 million instead of our initial forecast to BRL 420 million.

But, I mean, it will depend on the dynamic of the segment during the year. But we believe that we can reduce the CapEx from our initial forecast.

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

Okay. Thank you. Very helpful.

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 S. Souza e Silva {BIO 20114864 <GO>}

Again, thank you very much for your time, guys. And myself and our team are available to answer your question that we need.

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.