Q3 2019 Earnings Call

Company Participants

- Antonio Joaquim, CEO
- Antonio Joaquim de Oliveira, Chief Executive Director
- Carlos Henrique Haddad, Chief Administrative & Financial Officer and Director of Investor Relation
- Gilmar Menegon, Ceramic Tiles Director
- Henrique Marcondes, Director & VP of the Wood Business Unit
- Marcelo Izzo, Head of Sanitaryware, Sanitary Metal and Electric Showers Metal
- Unidentified Speaker

Other Participants

- Antonio Heluany, Analyst
- Isabella Vasconcelos, Analyst
- Marcio Farid, Analyst
- Unidentified Participant

Presentation

Carlos Henrique Haddad {BIO 17599460 <GO>}

Good afternoon. (Operator Instructions) It is a huge pleasure to receive all of you here in our first Duratex Day, in partnership with Apimec Sao Paulo. We are changing the configuration of the event slightly, trying to show you a little bit of what Duratex looks like nowadays. It is a new Duratex. We're very proud of showing our products. Many of you already know it. But all of you here together, we hope that you do like our presentation.

With me in the event, we have the presence of Mr. Harold Thau, President of the Apimec Council of Sao Paulo -- Apimec Board of Sao Paulo, President of the Sao Paulo Apimec Board; Antonio Joaquim, CEO, Duratex; Marcelo Izzo, Head of Sanitaryware, Sanitary Metal and Electric Showers Metal; Henrique Marcondes for the Wood operations; and Menegon, responsible for Ceramic Tiles. We're going to share this presentation. I'm going to make a quick introduction, show you the results as a whole. Perhaps you have already seen the results, but it's always good to put everything within context.

So with regards to the results of the third quarter, unfortunately the market is still not performing as we would like it to do. Even so we have noticed that in some segments, specifically with our Deca operations, we have seen a more positive movement, specifically with regards to the second semester when compared to the prior year. So here we have a significant revenue increase. It is important to stress here to show you that this revenue increase has the incorporation of Cecrisa in our results for the months of August and September.

So for you, analysts, I know we're going to try to clarify what we did when Ceusa entered, when we started with Ceusa. We're hugely satisfied to see the EBITDA evolution around 2%, which is a good path for us. It's the right path, in spite of the fact that the volumes are below what we expected. And net profit needs some explanation. Last year, there were some events -- some extraordinary events, specifically with regards to Wood, relative to the re-evaluation of biological assets. And the BRL30 million from this quarter had an impact of BRL20 million relative basically to the restructuring of the Cecrisa debt. We incorporated the debt and I'm going to tell you a little bit more about what I'm talking about. We are doing -- we're accelerating the renegotiation of Cecrisa in order to have -- to get to Duratex costs level.

With regards to cash, we noticed cash generation which is much more positive than we've seen in the last quarters. The highlight here as well as the EBITDA consistence, is cash generation through working capital. We've been talking about working capital. Unfortunately, the June closing, because of production adjustments and also the market, you can't see the results so well. But now we can clearly begin to see cash flow delivery before and after extraordinary events. We're getting two extraordinary events; the receipt of values coming from the forest, which was liquidated in the third quarter and also the value that we had to disperse because of the Cecrisa acquisition in the third quarter which, for us, is a huge satisfaction because this is long-term work.

You'll see in the next page. When we talk about working capital management, we did assume comparing quarters so that you can see the short-term evolution and it can be clearer for you. And now we begin to see lower working capital in stock, 10 days when compared to the second quarter. This means that we're working on working capital so that this can be another level for us. With regards to investments, the point once has to reflect here is the CapEx, the forestry CapEx. And after our forest structure, it is natural to have a lower CapEx, which you can see in the third quarter. And with regards to maintenance and projects, we can see that we have the doubling -- the duplication of the Ceusa plant, which is impacting BRL67 million, and we're almost concluding the project. And afterwards, we're going to see more details with regards to this in this presentation.

After a point to observe, we have the control and management of our debt. We're maintaining the leverage level at 2.5. Even after all the parallel events that are occurring, the debt is -- the net debt is in a fixed level. You can have [ph]the enter of almost BRL400 million with regards to the sale of our lands to Suzano and the disbursement to Cecrisa, BRL252 million; and the incorporation of the Cecrisa debt, BRL442 million. The work that has been done for some time, and we've been talking about this in the quarterly presentations, we have been able -- in the average term of our debt, we went from two years to 3.7 years. We were able to extend the average debt term. Only 3% is in the short term by the end of next year. So here, this is very reasonable. We have seven-year lines. So now the cost level is very positive. So this is the general results view, cash generation and leverage of Duratex.

Now I'm going to give the floor to Marcondes, and he's going to talk about the Wood operations.

Henrique Marcondes {BIO 20023372 <GO>}

Good afternoon. I would like to talk about -- I would like to start talking about Wood and the market, as Haddad mentioned, 2019 has been more difficult, specifically with Wood and the new entrants. We have been suffering a lot with the competition and this has impacted volumes. We [ph]can know less volume than last year compared to the same period. And also the net revenue. Now it's valid to consider with net revenue, this fight for volume is the issue of the mix, the Forestry panel. With regards to panels, when we consider the average revenue, we've been growing at 2.2. Now we have been able to grow the mix. It's richer. We're having more added value and the commercial policies gives us this return, too.

So when we consider the EBITDA, the margin EBITDA in the third quarter of 2018, was 17%. This quarter, it's 20.4%. Last year, we suffered with price. The cost was very bad. We suffered with that. Today, costs are more controlled. So I think it's worth to reinforce the issue of manage (inaudible) balance here considering this to 3.4 percentage points here.

With regards to add actions. Last year, it was a difficult year. It was very complex. We began with the sale of hardboard operations in the beginning of last year, and then afterwards we announced the first announcement -- we announced the first sale of the first tranche of land and forest to Suzano. We returned the Itapetininga plant operations. We've been suffering with this flex operations. In June, we announced the joint venture with Lenzing with regards to soluble cellulose. In July, the second tranche of land and forest to Suzano. In November, we decided to paralyze Botucatu. We went to see the location of plants and it became clear that Botucatu did not have the cost competitiveness that we needed. This year, we closed the sale of the Botucatu unit.

Now if we look at the Wood agenda, this commercial trade focused on differentiation is clear, because of the new entrants to fight with price, 350 cubes a month. Now we're going to have new entrants entering with broad products. So we're trying to work with regards to differentiation. So here, we have -- one-third of what we sell coming from these collections. We've been launching differentiated product so that we can stand out in the market. Competitive intelligence has helped to understand our competitiveness per pole.

So I know that in each one of the poles, it arrives with -- we know the margins we need to negotiate and this has been very -- bringing a lot of interest here. Also, sales execution has been good. These three points -- these 3 percentage points in the EBITDA increase is fruit of this work we've been doing. We continue having important volume. We need increasingly to be focused in cost. We have freight. We have operational efficiency. We are very -- we pay a lot of attention to this. With all the operations we did, the sale of forest and lands, we promoted an interested adequation of assets, so things have been very interesting here. This is the main summary.

Now I give the floor to Marcelo.

Marcelo Izzo

Well, I'm not going to tell you about the difficulties we've had. In general, we've -- we need the region from -- I am so happy that somehow we tend to increase what I've been saying to you, with regards to our strategic growth agenda that I'll be sharing with you in the next chart.

I have been talking that the best way of analyzing the performance of Deca in this moment -- in this transformational moment that we want to increase unit revenues, gain of margins, gross margins because of the greater operational efficiency. And obviously, the organization's operations, which led to a growth of recurring EBITDA and EBITDA margin. So here, when we look at the volume performance we had, we lost 5.6% and this is explained by two variables. One is the problem with the consumer market. And also it caught us by surprise, which went to a better management of working capital by our clients. And they started not to have stock. So the idea -- a sellout is always going to be great than the sell-in. So we have a characterization of margin EBITDA of 5 points. 2.6 -- 2.5 comes from the retraction of consumption and also because of the reduction of stock inventory by clients. And we believe that we are partially flat in relation to our market share.

The drop in volume when we look at the revenue, when we consider it, is basically occur for our capacity to implement price. And this improvement of our unit revenues summed with our efficiency projects made our gross profit, even in a bad scenario, with revenue grow 8%, which allowed our gross margin with regards to 2.3 percentage point in the recurring EBITDA. EBITDA margin. I talked about our management, our expenses and the reorganization design. So the EBITDA, 16.9%, and this is a reflection of our performance, which is around 17%, which reflects the percentage gained that you have with gross margin and because of our management. As I said to you, these results is a mirror of our strategic agenda that I'll be sharing with you.

Basically, a year ago, we designed a strategic growth agenda. The important factor to work was our aim, which was solutions for better living. So here, I've shown you, many of you, we worked in a very intense way to detail a scenario where we understood what the difficulties we've had and to be able to create a preferred future. So we had to have a design for this. Here, we established the project. And from here emerged six strategic pillars that goes through our efficiency, logistics, innovation, market intelligence in action, excellence in sales execution, new revenue sources, and human capital, which is fundamental for this.

So when we consider this, we defined a way and we decided we wanted to define what was the most important pillar that could generate results in the short term in a faster way that we could expect. No way, this is tangibilized by the number of projects that we have reached one of the pillars. What we said at the organization is that the first 24 months of this agenda would be very concentrated in industrial and logistical efficiency. Going through innovation. Why innovation. Innovation is when you begin to work in order to deliver in 18, 20 months. So we needed to begin with -- we needed to work both of these things together to tangibilize what we did during the last year. Imagine that we began October last year.

A good part of the projects that I think is important is what we've done in terms of industrial and logistics efficiency. We reduced the portfolio. Last year, we reduced 30% of the Deca portfolio. We removed complexity. This removal of complexity was more operational than anything else, and this led us to have a significant improvement in productivity from IQG, which is General Quality Index, and obviously a message where we see productivity. We did the transfers of the maximization process of our industrial assets. We closed the Tubarao plant. Recently, we did the transfer of assets without loss of capacities. We had the reduction of headcount. And we began a fundamental process mentioned in the beginning of the presentation by Haddad. It's just how much we must focus on working capital management of the organization.

And somebody asked me outside how our EBITDA was, so we have had a consistent removal with lead time and all the rest. Innovation, one of the things that we need to do, which I think is very important. This is an implementation of a new innovation funnel. We managed to reduce our time-to-market for development and launch in four months -- by four months. This makes us feel secure and safe and we want to remove that negative perspective we couldn't sell because we didn't have productive capacity. This is a little bit of what we lived in the past. So now we feel better in affirming just how much we're innovating.

And the other one which I think is huge, it's very important for us, which was the launch of -- within a new concept and so of -- within our new concept, which is you find a partner, and because of the strength of the brand that we have, which is Deca, perhaps it's one of the greatest assets we have in the organization, this would allow us to have a product which delivers the quality necessary. We began commercial execution works, too, with the redesign of our commercial policies. It takes 18 months. We're in the final phase of creation of the governance and the processes. And this will happen -- this will result with a more holistic management.

We restructured the trade marketing area and a fundamental point was the integration of Hydra and Deca. We delivered the -- we integrated the back office, the sales force and captured synergies. This is a snapshot of what we did in the last year. And these are the projects that are tangibilizing these results -- these positive results and that mirror our strategic five-year agenda.

Gilmar Menegon {BIO 20654325 <GO>}

Good afternoon, ladies and gentlemen. Now we're going to talk about the highlights of ceramic coatings or tilings. We had considerable volumes in growth, 4,000,939 square meters. Net revenue, BRL36.4 million and 4%. And this is because of the consolidation of August and September. When we look at the recurring EBITDA, BRL32 million, with an EBITDA margin of 17.9%, 0.9% below or in line with the prior quarter. And this is the material -- this relevant fact changed things in the company.

The first one was the operation of lines three and four in the units. The Santa -- we have planned to begin operations with the expansion project, which leads our productive capacity from 6 to 11 million square meters and great formats. We did this and the production -- in the current production lines has an industrial cost, which is 40% high. The good news is that the sale was 3 times above the expectation, but it corrodes our results a bit. The second was the closing and the results from Cecrisa. We tried to capture synergies and we closed the Santa Luzia unit in Minas Gerais, which was planned for 2020. But we saw that it had negative operational results, so we did that. With the use of our capacity in our industries, is 90%. It's very high. It had been operating at rates of 76% occupation. Now I'm going to talk about the integration and synergy of the brands until then Ceusa and Cecrisa and then Portinari.

Now I'm going to talk about the characteristics of each brand so that you better understand how our integration process will work. So who is Ceusa. Ceusa is a company focused in creativity, maximalist design with very colorful products, intense colors. It is turned to fashion and it has exclusive differentials. We're the only company in Brazil that can produce monotone and mono-caliber. Each ceramic, each production has a new tone with a new batch. And this differential, we can have the same tone and the same size. Monotone, mono-caliber. So we're the only company in Brazil with dry joint. Our focus, our process differential, is the differential.

So we have a project, which is the focus on process, and the idea is they produce 100% extra quality by 2022. 10% of the production is second quality. When we're simply working with high end, we have problems. So how do we do. Through the investment in the 4.0 Industry, and then we had -- ICEP is 100% control of production and statistics -- control of statistics via mobile. It's 100% digital. 15,000 daily collections done, 630 points. And the maintenance and management system, 60% of maintenance was corrective and now preventive is 13% -- 87% preventive. This whole system is done and controlled. The process control is mobile in the plant floor and both units do not have manager, leaderships or coordinators during the weekend. And with regards to digital experience, we have EaD and SimuLAR which -- the idea here was to have 7,000. Now we're going to impact 20,700 people with training courses. So Ceusa is focused on excellence and process differentials.

Portinari. Portinari is a brand. It is much acknowledged. It is a high-end brand focused in minimalist design. It's maximalist with intense colors, Portinari is minimalist. Ceusa is maximalist. Portinari is minimalist. It's a premium brand in the high-end market. The differentials was the consolidated channel of specialized stores. Portinari concept with 380 clients where the Portinari brand is used. 42 clients are exclusive Portinari clients. So there is no other ceramics that works in these stores and they are Deca clients and also leadership in digital media, 10 times greater than the second place and like. Portinari has around 40% of likes in ceramics coatings in Brazil.

And the other one, the other differential is the digital platform, Agile Promoter, where 100% of our promoters are accompanied online via mobile. We did all the portfolio, pricing, positioning through this systems without producers. Innovation with color connection, which is a chromatic scale of our products that works with other products. And we can see environmental elements. The chromatic scale composition can be done with metals, sanitaryware, and other products. What is clear here. Ceusa is a company turned to processes with strong process and exclusive differentials. It is the only company in Brazil that produces monotone and mono-caliber, and it's the second company in the world to do 100% here. Portinari is a desire -- 100% extra. Portinari is a differentiated company.

With these differentials, I am certainly that we will build the best ceramics, coatings or ceramic tilings company. How are we doing this? Today, we're doing this. We have a very accelerated process of synergy integrations. The first one is brand synergies, the discontinuity of the Cecrisa brand with low end. We had Ceusa and Cecrisa. Cecrisa the -- so the companies are focused in Ceusa and Portinari for high end. Secondly is portfolio management. Discontinuation of the low-end products of the Cecrisa brand, a broadening of the production of internal products, high end. Neither Cecrisa or Portinari had the capacity until then of the production of 120x120 and 80x160 formats. But now with the expansion, we began operations which was planned for September. Now we started operations on 25th of October, with production capacity. These products acquired by Portinari via outsources have greater cost than our current productions.

So our margins will be much greater than practiced today. Capture of synergies is administrative and commercial centralization. We're going to centralize our administration to one site only. We've -- the two companies together went from seven to three Directors, 42 managers to 17. So we have a lighter and a more agile structure. Standardization of suppliers. A total of 630 raw material units. Now we're going to work with 280. So the standardization of material with less suppliers reduce the number of products to work and also include reducing costs. As I see it, another relevant factor was the unit in Minas Gerais, which the operating results was negative. The project was to close in 12 months and in less than 60 days, we closed the activities of this unit.

Another advantage that we're going to have with integration is the consolidation of loads, which is a strong logistics differential. Today, we have in operations five DCs, one in Minas, one in Sao Paulo with great formats, and the outsourcing. These products will be done internally now and three in the south. Three distribution centers in the south. And the project to optimize lines, processes and factories. We have several -- so with the union of industrial units, we're going to try to produce products. Each [ph]stove will be dedicated to one kind of product and typology.

Expansion. We will be certainly the only industry in the national market which is 4.0. All process controls are done in a digital way. The whole plant is operated with robots. High-level. High-performance. The industrial unit operates with 18 people per shift. So it's a very high-productivity plant, low-cost and high added value. It is dedicated to large formats and it is one of the few in Brazil to have the capacity to produce 120x120 and 80x60. And the experience of digital that we have in the processes and we are obviously going to transfer this to other units of consumer. With the expansion going into operation, our capacity which was 6 million square meters, with Cecrisa acquisition, 20 million, and now five -- with the expansion of five, we're going to have -- we're going to go from 6 million square meters to 31 million square meters a year.

I am sure that with the knowledge we have today, the processes of the units operated with the Ceusa brand and with the market differential of Portinari, the Cecrisa brand, and all the strength, the strength of the two brands, we're going to obviously build the greatest company for ceramic finishes in Brazil. A more innovative company, more productivity and better operational results, adding the best services.

Antonio Joaquim {BIO 20772346 <GO>}

So good afternoon. I'm going to close here so that we can debate the results, the strategy of each business unit. I think we insisted and we wanted to show you all these details. And here, I'm going to close with a more strategic eye on the organization as a whole with regards to Duratex. So what happens. We, now in Duratex, doing two important transformations at the same time. You've heard of the cultural transformation, the whole process, innovation of people. We've talked a lot about this. And also we have a renovation of portfolio. We're adding a new business in our Duratex portfolio, the joint venture with Lenzing with dissolving pulp, which is a product with huge perspective in the global trade.

All these segments, the industry of more intelligence fabric, Dri-Fit underwear, all of this is growing hugely and very, very fast in the world. So we had the opportunity of going into this business and we are building a project with huge competitive advantages. First, we decided to build a plant of 500,000 tonnes a year rather than 450,000 tonnes, which was planned before, because it was for a very technical decision. We verified that we had -- with very little additional value, you would increase the production capacity by 10%. So this was an important advantage. This company should have a cost -- if there is another one, it's going to be very close, but it's going to be the lowest cash cost in the world.

The logistics is completely integrated for the industrial unit is in the forest, and this is one of the reasons that you have a lower cash cost, because the average distance of supply for this operation is very low. In any pulp projects that you know, one always talks about averaging distances of more than 200 kilometers. Here, we're talking about 40, 50 kilometers. At the moment of operation peak, it might get to 70 kilometers. So it is something that is very important. Obviously, 100% certified it is by FSC. So you have the opportunity of having that plant. The plant that is extremely well-designed. Extremely. This joint venture, the total industrial investment is approximately $1.2 billion, so we're talking about BRL5.2 billion. The shareholder structure, Lenzing is the controller with 51% Duratex, 49%.

Lenzing, we've said, is a global leader in the production of this type of fiber, and the product is destined to it, with a purchase guarantee of contract, which is a very well-structured business. The productive chain is very curious. You go through the forest, turned into chips, cellulose, fiber, goes to the Lenzing plants in Europe, where it becomes a special thread. And then you have applications in medicine, textiles, non-textiles, fabrics. The expectation of growth is very important. All consultancy companies -- in a way, this competes with cotton fibers and because of the use of water in areas which is much more intensive for cotton, the characteristics of special fabrics, you have -- with younger people, they like it. They have more interesting type of cloaks and fabrics. And all of them are

Lenzing brands. So we have one single block of 44,000 hectares of forest and the plant inside it.

And now, the Duratex portfolio. Some of you, a market analyst at one moment said, no doubt, today we have a transformed new company, a transformed Duratex. We left the company with two business, Wood and Deca. Wood represented 70% of this portfolio and now we have a portfolio with four different units, with different levels of capital allocation. With regards to cellulose, it is slow. It is capital intensive, but it is a very leveraged project. So for us, this is low investment because mainly, we -- the contribution of this investment -- this investment was for Duratex are the forest that we already have in Minas Gerais. We have growth potential in some of these businesses. Wood, for example, soluble cellulose. The growth potential is more organic, specifically with regards to wood. In Brazil, we had difficulty in consolidation here because we have a very relevant market share. So it is not part of -- this movement is not part of our strategy.

Deca, for example, we have growth opportunities. We still have opportunity for growth, organic and inorganic growth. In terms of discipline of offers, we still have an imbalance between supply and demand. This is a result of the crisis and we have new entrants that arrived in the crisis. It didn't seem very logical, but this happened. With regards to Deca, there is always risk of new foreign entrants. But Deca operates with very relevant market shares, which is over 40%. So we are very well prepared. And the risk hasn't existed before. It was theoretical model. But it never happened, in fact, because it was very difficult to enter and operate in Brazil.

You all know that it's like this ceramic furnish. It is a very fragmented market. The graded -- the largest companies in Brazil have very small shares in the market. We -- our value share is much greater than the volume share. So it is a segment that still has potential for consolidation. And you saw -- and we are focusing in the high-end segment. There are two worlds of ceramic furnish. There are the middle and low end and there are the more high-end ceramic furnish. So we are very competent. In Brazil, we're very competent in both of these things. In this low-end market, in Sao Paulo, they work -- operate in a very productive way. We don't want to go into this segment. We want to focus in adding the value here. And then cellulose is a global commodity.

In terms of competitive advantage, we have strong cost of production because of forests and very well setup wood and soluble cellulose plants. We have a strong point. We have good costs here, specifically with the expansion. What Menegon said is very curious. We are in great format. We had 3 times greater demand than what we expected. And results are going worst, but this is because we're producing with the old lines we had. So as soon as we go to this new line cost of production, will drop drastically. So this moment that we have with margins, which are more depressed in this third quarter, is very specific because of the entrance of the new lines, Portinari, Ceusa. And we're trying to optimize this to recover the usual margins and this is going to be very fast.

In terms of competitive advantage, the great advantage is brand and design. This is not something you buy. This is a hard work. These are very consolidated brands that help us a lot in this commercial moment. And also, with the entrance of soluble cellulose, we have an interesting balance here because we are exposed to the internal market here. If we consider Wood, Deca, Ceramic Furnishes, Deca a little less. Deca is around 15%, 20% export. Ceramic furnishing, 20%. Deca has 5%. So we have a business that is completely valued. So it include -- it increases -- it improves our balance.

And the process of cultural transformation. We began in 2015. It is a very important process. We created Duratex Management System. We worked with base -- Zero-Based Budgeting. And we began to acquire assets, Ceusa, Decora, Cecrisa and these are the movements. And in that, we consolidate assets, trying to find important opportunities in this regards of the sale of forest assets. These are opportunities which was very important. We had a very fast execution in order to capture value. The soluble cellulose is ideal for the area that is available in Minas and the Ceusa expansion project mentioned by Menegon. So we're going to go -- we're going to go through a lot of digital transformation and innovation. We have a specific Board to -- specific people to deal with this. We're focused on this. And I was able to participate in the second round of Duratex, and we accelerated seven start-ups.

So we're coming close -- we're coming -- we're going to a more dynamic market like the start-ups. This is very important. We have a number here, so that you can review the meaning of this. Cultural renovation means an impact on the renovation of people. We changed 84% of our team. You can see everybody is new. Only myself only, I'm from the old ones. So we have a very important operation. This mix is mix with older people, younger people, external culture. Duratex becomes a more dynamic, more inclusive company because of this.

In terms of -- we're still really considering very strongly sustainability, developing new people, trying to have -- develop a positive impact, social environmental impact. We have municipalities that transforms revenue. The project by 3 or 4 times. So we're learning with this. This is a very important work. 10,000 collaborators that we have already been able to train for sustainability. It's not just a thing. We show how the sustainability model can generate revenue for us. We're doing this so that -- because we believe that sustainable business will generate more value in the future.

Lastly, I would like to say that we are extremely focused. I am not at all satisfied with results, but I am extremely satisfied with the path we're taking. This that we're building is very important. We are focused in the maximizing shareholder value. Executive pay is 100% based on EVA and short-term executive is based in cash flow and generation of EBITDA. We have a sustainable growth. We have plans. We have a long-term strategy that is consistent. And we have -- we know exactly what's going to happen. And we know that there are things that we don't know, but we know what we want. So we're tracing our path.

Strategic assets. The transformation of wood. For those of you that have been monitoring Duratex for a long time, it's the greatest event for the company in terms of business transformation. The sale, the transformation which closed now. Now we have four industrial units. The forest is enough for this. It's very well located. So this is a lean company in this sense. And also, we're also working strongly, and I believe this is going to be the vision from here on. We're working in client solutions on -- within our (inaudible) solutions. We're working one-stop shop with complete experiences within the environment, offering better experience.

I would like to thank everybody that organized things here. The idea is to give you a view of the possibilities we have. One of the only companies in Brazil with the possibility of portfolio of supply for your home. Complete going all the way from wood, floor, the benches. There you have -- you can see what is possible. All of this is clearly based on those pillars of our culture. And this is what I had to say.

Now we open for questions. Thank you very much.

Carlos Henrique Haddad {BIO 17599460 <GO>}

Good afternoon. Before we begin for questions and answers, I would like to have the honor and says Duratex [ph]ready for you with meetings, analysts and professionals. These are very few companies that have managed to attain this level of opening, formation and continuity like Duratex.

Questions And Answers

A - Antonio Joaquim {BIO 20772346 <GO>}

So now I would give the floor to Haddad. (Operator Instructions). Thank you. So I have a question here in the front.

Q - Antonio Heluany {BIO 20614129 <GO>}

Good afternoon. Antonio Heluany, Bank of America. Congratulations for this event. My first question goes to Marcondes. Could you please tell us the dynamic of the panels market? You've already told us the situation in new entrants. So how is the energy of these companies here? And also some traditional lines we've heard are going -- are in the red, very close to the red. So what is going to happen to change this dynamic in the market? Can we expect a closing of capacity or eventually a consolidation?

A - Henrique Marcondes {BIO 20023372 <GO>}

There are two different characteristics, dynamic. You have the furniture industry. There, we've had a certain supply-and-demand balance. I don't think this is a problem. With regards to MDF, in retail, the challenge is struggle with new entrants. It's very difficult to read this. When we saw this, we already knew that it participated in some post -- some prices below cash cost with the truck drivers' strike. There was a lack of energy here. So we do see signs of new entrants and we do see financial difficulties here. We have mapped -- we have a commercial intelligence area focused on these information. We capture clear information that it's not easy, and also derive from this to our cost. So we see this problem with price deterioration with -- we don't see this, but we see this migration. And it is very difficult to do this projection. What we see is that there's room to attack some markets here.

Q - Antonio Heluany {BIO 20614129 <GO>}

My second question, [ph]Luis congratulations for the improvement you've managed to implement. What can we expect here in the future in terms of margin improvement? What is the potential margin level with the current portfolio considering the midterm?

A - Unidentified Speaker

Thank you very much for the good results here. The idea is to be able to go to the next quarters with increasing margins. This is part of the strategic agenda. At one moment, we don't see problems here. I always say to analysts, with regards to Deca, we have to stop considering quarter-by-quarter but year-on-year, because of the mix we have the seasonality. So I always say to you, if you want to validate to see if the strategic agenda of the Deca agenda, if it's well implemented, we have to consider three things; implementation and increase of the unit revenue. So we have a leadership position, and we can have the market generate value through price increases. Gross margin. This drastically reflects our process improvement, productivity, efficiency and obviously, our management of physical expenses with EBITDA. So the strategy here is being tangibilized with this purpose. This is the expectation you have to have.

Q - Unidentified Participant

[ph]Marcel from Citi. Congratulations for the event. I would like to ask what level of leverage can we have Duratex doing new M&A movements here. This question goes to Marcelo.

A - Marcelo Izzo

This a good question. Duratex, one of the reasons we are obviously -- well, we have a growth plan, which is very aggressive. We have aggressive objectives. The idea is to have a drop in leverage, which is important in a relatively short term. In the fourth quarter, you're going to see this. You have new entries here. So here, we should have this leverage go down in the short term, mainly specifically next year. So the company has a good potential. It has a lot of money in the market. So we have good business. We have a good potential for leverage. I consider and this clearly depends on the levels, capital cost in the market, one usual leverage to maintain between 2 and 2.5 in a non-expansional situation is very healthy. So we should not have -- we should not bring it way below. If we leave it as it is, very soon, leverage will be below one and this is not reasonable.

So to maintain -- if we don't have projects, we'll be paying dividends. But we should maintain a leverage here. And considering the project's hypothesis, we have our COGS combined with controllers and things that are being arranged with controllers. But I don't think that -- with regards to project, to leverage to 3, 3.5. With regards to special project, it could be very possible, too. So we do not have a short-term plan with regards to this. In the short-term now, we should see a deleveraging of the company and payment of dividends. We're going to have to evaluate things here. We observe that the growth of the cellulose plant will allow the planned financial contribution, which will be greater investment there, will be greater. So four projects that we have. Cash generation should be perfectly feasible.

Q - Unidentified Participant

And also Cecrisa, what margins can we expect for next year for Cecrisa?

A - Marcelo Izzo

As we've shown, we're going to operate with the integration of investor units, aiming to reduce costs, optimizing processes. And also, we talked about the integration of the commercial administration teams. So the trend of growth will exist because the profit will increase and costs and expenses will reduce. Be patient because we're very impatient going -- to go after these results. Menegon was being very careful because I can't say more than we planned. But that I'd be saying to you, you can certainly expect this will happen. And by 2020, we'll operate in the margin level sales ahead before for the whole operation.

Q - Marcio Farid {BIO 21017394 <GO>}

Marcio Farid, J.P. Morgan. Two questions. First with cellulose. I want to know if the numbers you showed us today, just the last numbers with regards to CapEx capacity, do you have the go ahead of the Board? And if you can quantify what we can expect in terms of production cost, unit production cost for soluble cellulose when operations begin? Second question later.

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

We are in a phase -- and I wouldn't like to -- we already have a very precise vision, very close to what is going to close. We're in the last phase of negotiation bid with suppliers. So this number that was mentioned here is the number that we should have for the end of the product. And there's no surprise here. With regards to costs, we're still in the -- we're still in a phase where there is important alternatives that can impact things, whether we're going to offload this through Espirito Santo -- through Santos. There are several ongoing products here, so we don't have a precise vision. That number that I mentioned, what we said, our worst-case scenario is the one I showed you, which is still the best cash cost. So we see important alternatives. But we're in a phase we're closing the bids, which should extend to the end of November, beginning of December.

We also have the formalization of the go-ahead of the Board. We don't expect any process here but ourselves, unless these are companies we're going to have Board meetings formalizing both companies. They have been authorized to continue with investments because we believe in the project. But we're going to have a formalization here. So I would like to formalize these numbers only after the go-ahead by the Board, by the different Boards. And we believe this will happen by the end of this year or something of the sort. We don't expect anything different in terms of the numbers presented.

Q - Marcio Farid {BIO 21017394 <GO>}

A follow-up on cellulose. The CapEx per tonne seems to be a little over the average we observed. The CapEx per tonne seems to be 20%, 40%, what we saw with other projects in Latin America recently. I understand that soluble cellulose tends to need more consumption of wood per unit. But there is -- is there -- there's something here with logistics that might burden this CapEx, something that happens here, something that differentiates it here.

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

Well, this is what you explain. All the projects that were in the region recently were not soluble cellulose. I think you're comparing it with projects such as (inaudible). These are very different numbers. We have two things that differentiate soluble cellulose. One, the investment in industrial unit of -- is greater than the investment in -- than in the investment in a plant with common cellulose. The production scale, when you see a project such as (inaudible), we're talking about 1.5 billion tonnes, 2 billion tonnes. And here, you see a plant that, at the first moment with 0.5 million tonnes, is the greatest line in the world. So the scales are different. So cost per tonne is greater with soluble cellulose, and the price of this product in the market is definitely greater than common cellulose. It's normal. Much to the contrary, we do expect to have a production cost, very important cost. In Brazil, there's only one other similar project, which is a recent project, which is being done by Bracell in the inland Sao Paulo. But it's a different plant also because it's a flex plant. They can produce one thing or the other. So there, I don't know the numbers, but our numbers certainly are below world standards.

Q - Marcio Farid {BIO 21017394 <GO>}

Second question now, market vision for civil construction next year. Results were reported this morning with optimistic results with regard to civil construction for Brazil next year. Do you agree with this opinion? And what can we expect in terms of some growth numbers here -- numbers for growth here?

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

We are optimistic, but we have to remember one thing to talk about Gerdau. Gerdau has a product that enters the beginning of the construction works. We, no doubt, saw in 2019 a recoup of the launches in terms of civil construction. And this was very important. I have been recently with owner of construction companies, and they're very satisfied with profit performance in 2019. There was a recoup of the sector. And we have to remember that with Deca, wood and furnishings, we entered the end phase of the construction work. So there is a delay. So you see, I'm optimistic for the situation by the end of 2021, beginning of '21, yes, because we're going to get all of these construction works that are here. So when we look at Brazil and the construction markets, I -- not only construction markets, but we have to consider still we have mixed feelings here because we have a very good economic agenda. The reform of these processes that make us very optimistic, but we have very tough political situation still. So if we specifically look at the sector, we are optimistic because it's always that belief. We went way down the drain. We were the segment that most suffered. And clearly, in 2019, if you look at all the indicators, the launches, the sales, they are very positive.

Do we have any more questions?

Q - Isabella Vasconcelos {BIO 20566061 <GO>}

Isabella, Bradesco. I have two questions, very quick questions. The first one, you've already integrated a program of assets, and I would like to know if you have any more asset opportunity that you see in your portfolio. And my second question has to do with the ramp-up of the Ceusa expansion. And how do you think this is going to happen?

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

Could you repeat your second question?

Q - Isabella Vasconcelos {BIO 20566061 <GO>}

The ramp-up of the Ceusa expansion.

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

With regards to your first issue, yes, we did see strongly the investment program, alienation of assets. So wood finalized its cycle with regards to this. This last movement was, in fact, the last movement we see in this sense. Forests and plants are completely adjusted. Anything now is fine-tuning. Oh, I change a close of farm to one that is further away, but nothing of what you've seen before. We are still investing in forest in the Northeast. We have a project that guarantees wonderful opportunities. We have very interesting opportunities in terms of wood exploitation. So we have very interesting things here. And at the moment, there is a recoup of the economy. We can certainly say that we can have the expansion there, too. But this is something that is still far from us. We have idle capacity that is important, but we do not have any relevant movement here.

Deca, Marcelo explained, we transferred assets, closing the operations in Sao Leopoldo. For Deca, we don't have to expect that we're going to close a whole industrial unit. This can happen. We're doing this. We're transferring the production of one plant to the other, change optimizations of the mix, but we're not closing plants. And ceramic finishings -- furnishings. We bought in order to close some units, but we're closing operations of the Anapolis plant in Goias, the one in Santa Catarina and also the one in Santa Luzia in Minas Gerais. This was a small operation, and we're concentrating in these four plants. These four plants for ceramic furnishings, they're -- they will be modernized and the operations will close.

Now with regards to the ramp-up of the plant, Menegon, do you want to speak?

A - Gilmar Menegon {BIO 20654325 <GO>}

It comes in a very opportune timely moment for us because this is an important moment for production capacity. It goes from 6 million to 11 million. And now with the acquisition of Cecrisa we do the ramp-up with large format. These are imported products, imported by Cecrisa and Portinari brands in the concept launch. So we're going to produce this internally because the cost of production will be lower than the imported product. So in November, we're going to be producing 40% with the Portinari brand, 60% with the Ceusa brand in this industrial unit. It is a very modern unit, which can produce very colorful products, the Ceusa, product and minimalist, with large format in the same production line. Just to add to this, we're used with the ramp-up with wood plants, metal plants. Here, the whole thing is very fast. This plant, possibly in January, will be operating fully.

The ramp-up is fast. And what speeds this up is the issue that we were designing for -- we designed -- the idea for Ceusa to be able to do this, it had to enter the Portinari world. With Portinari, Portinari needing production, importing at very high cost. So this will speed up time for adjustment of machines and programs, and it will be with full production. Thank you very much.

Q - Unidentified Participant

Good evening. [ph]Leonardo Fantini, Citi Investments. My first question has to do with the integration of the sales teams. Do you have a consensus here with regards to this? And my second question has to do with the pulverized market of ceramic furnishings or coatings. Do you have a player here? Would it make sense to do any kind of acquisition movement? And would this happen in the short term or perhaps in some years' time?

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

We -- until 30 November, we should have 100%. All the teams in all layers, 100% integrated. We worked strongly in the choice -- we had seven Directors. We went down to three, 40-something managers, we went to 17 -- 16, 17. This is a strong movement. Of course, this impacts the company. You have many people being laid off. You have a lot of processes. So we worked strongly with human resources in the choice of the team.

Q - Unidentified Participant

We didn't say you have to have so many.

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

No. We wanted to know the best. We chose a general director at Cecrisa, the directors from Portinari. Now we are dedicating ourselves. Now we are dedicating ourselves now to -- we're going to work with sales. We're going to have one single team selling both brands and we hope to complete this. The limit date is 30 December. And since nobody wants to do any kind of adjustments during Christmas, we want to work this -- we want to have this prepared already by end of November. And we're doing this in a very careful way. The integration of the brands, the most difficult thing here was not people or human. It is difficult. We have to understand that we have space, we have shelves. And we have to be very careful. We have to understand the situation of each client. We are considering the operation of promote as in Ceusa, which was outsourced. So we're uniforming -- we're standardizing this.

Your second question. To analyze, we analyze things every day. We obviously monitor the market. It is no priority. We don't want to grow simply to grow. We are very satisfied with the size of the operation, which is around 30 million meters. This is very good for us. What we're first focusing on is to have a 30 million-meter operation with EBITDA level margins that we had before, first focus. And then afterwards, if we have the opportunity, of course, there is the opportunity of consolidation. But we have strong competitors, groups that are growing, so we believe that the business arena will -- does offer opportunities. But we're not going to go off by it. I don't need to have 40, 50. We're not going to do any consolidation movement that will lead us to a worse mix. Definitely not. This is not the idea to lead us to a lower margin. We are focused in this aspect of revenue share. We're very focused on this.

Q - Marcio Farid {BIO 21017394 <GO>}

Marcio, J.P. Morgan. There's one more. Antonio, you talked about the availability of forest in the Northeast. We've been monitoring the global wood market. And we know of the potential deficit that exists in the Iberian Peninsula, Indonesia, China, Japan. Is there a possibility of doing an exportation movement in the short term or a more structural movement, more aggressive long-term movement focused on the exportation of wood with the idle forests today?

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

Yes, we are working on this now.

Q - Marcio Farid {BIO 21017394 <GO>}

What happens?

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

We have forests. We have very interesting opportunity in the region because our forest space is leased. So the CapEx there is low. Forests are exceptionally good. They're the best forests we have, and it's a very privileged space. It is not a region that allows for very large-scale operations. Let's have a cellulose pulp plant there. No, we don't have 150,000 hectares, but we are maintaining 10,000, 12,000 hectares. And we have a possibility of going to 10,000, 20,000, 30,000 hectares. We have this possibility. Within this asset-light model, we are getting -- the first forests are ready now after six years. So I would say it's very interesting because we have two, three projects and we're choosing these projects. They're very low CapEx projects that allow us to generate or export wood.

All that you said is true. There is a very large demand. There is no problem to place this wood. We're choosing the best project. We're going to do this. And this is a project that allows us to continue operating it and generating its own reinvestments of this. It's a very profitable operation, very interesting operation. It's very asset-light and allows us -- at any moment, if we eventually decide to have an industrial project there, you can simply interrupt our operations and no problem. So we should, very soon begin operations in this sense there. And we're working on this by the end of the year.

Last question, people? Otherwise, there'll be no cocktail or nothing else. Okay. So I would like to thank you for your presence. It's almost record presence. And we invite you to look at our environment, to look at this process. And you have Haddad's team, Natasha, Guilherme, everybody at your disposal. All the Directors are here too. Thank you very much.