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Q1 2012 Earnings Call

Company Participants

- Alvaro Penteado de Castro, IR

Other Participants

- Lucas Ferreira, Analyst
- Unidentified Participant, Analyst

Presentation

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.

(Operator Instructions).

As a reminder this conference is being recorded. I would now like to turn the conference over to Mr. Alvaro. Please go ahead, sir.

Alvaro Penteado de Castro {BIO 5537843 <GO>}

Thank you. Good morning. Good afternoon, to all of you who are in Europe. Before starting the discussion about Duratex' performance during the quarter itself, I would like to make some comments about the business environment that improved considerably when compared to the Europe struggle in Atlanta [ph].

The reduction of the interest rate the almost full employment market, the expectancy for GDP for the year to grow a minimum of 3% and more recently the expansion of borrowing terms and the reduction of the banking spreads specifically in the banking side are contributing to a better reading or a better momentum for the industries that we operate.

Speaking specifically about the performance of Duratex during the First Quarter and starting to address slide number two of the presentation, I would like to point out that in this sort of environment the performance of the Wood division posted an increasing volume by 16% and in Deca we posted a 5% increase.

Net revenues totaled BRL737 million, which represents a growth year-on-year of almost 12%. EBITDA reached almost BRL209 million with a growth of 14% year-on-year. This is important to notice that even with a higher cost base year-on-year, we were able to improve the performance of EBITDA and also of the markets as we will see further in this presentation.

The better price base in Deca, the higher volume shipped in both divisions and specifically the dilution of fixed costs contributed to such a performance. Net income increased by 12% year-on-year totaling almost BRL90 million. And on a quarterly basis almost 9% increase.

All the situation, this macro environment and the performance of the Company, they justified the investments that we are conducting still in the Company. We are announcing an estimated CapEx for the year worth BRL650 million, of which the highlights are the adequation [ph] or the bottleneck meant [ph] of the MDP line in Taquari. Currently the effect, the available capacity of this line is for 130,000 cubic meters and with margin investments we will take this capacity to 670,000 cubic meters.

We are also keeping the pace with investment in Itapetininga through a new MDF line with capacity of 520,000 cubic meters. The equipment for such plants they are in Brazil already and the assembly process should start in this month or in the next the latest.

We are also conducting investments. This is a refute for a new plant in Queimados. This is a ceramics plant with a capacity of 2.4 million items a year. And the conclusion of this investment should be by year end 2012. Also in metals or in Deca, we are investing in metals to expand capacity by 1.2 million items a year. And since the growth in Deca metals is here the bottleneck meant [ph] top process, this growth of capacity should happen during the course of the year.

Slide number three brings the Abramat Index, the performance of the building material industry. This index measures the revenues of the building material industry within the domestic market. What we can see here is that during the First Quarter '12 the industry grew by 3.3%. Deca as a comparison base that the performance was up by 9.1% in the domestic market -- 9.7 total revenue growth year-on-year. And for the whole year it is expected a 4.5% growth which means that Deca is growing much faster than the building materials industry as a whole.

Following page on slide number four we have a history of the last five quarters of shipment in Deca. You can see that year-on-year shipments increased by 5% and quarter-on-quarter a reducement [ph] of 10%. Here probably some explanations are backed [ph] to the price increase that we implemented in the Fourth Quarter itself and to some seasonal adjustments during the First Quarter '12 comparing to the previous quarter. But on a more broad analysis we still see the market with very favorable conditions.

I'm talking about the construction market. We still see financing availability and even the terms offered to finance acquisition of new homes they are out to 30 years, nothing changed in that sense. If you analyze the more mid and low income segments also the conditions didn't change. Probably what changed is the conditions in the construction industry itself. Probably they will have to refocus to keep growing on a sustainable basis.

Slide number five brings information about the wood panel consumption in Brazil. So this is domestic consumption in cubic meters in Brazil for MDF and MDP. The performance year-on-year was very positive, remembering that the beginning of 2011 was specifically very difficult given the adjustment in inventory levels in the 42 [ph] chains because of the changing macro environment.

In that time we had an increasing in cut rate scenario, with increases also in the factors over financial provisions turning the credit [ph] on the materials more expensive in short. And the situation changed completely. What we saw during the beginning of 2012 was an environment the opposite way, interest rates going down. And also some measures to keep the market demand. And such measures were more and more implemented in the beginning of the Second Quarter. But the overall market in our analysis is still very favorable.

All in all what we can see is that MDF year-on-year increased by 12% shipment in the domestic market. And MDP almost 16% increase. When we analyze on a quarterly basis quarter-on-quarter we see a reducement in MDF probably because of seasonal aspects. Normally First Quarter is more slow than the Fourth Quarter. And we did not see that in MDP most likely because of the expectancy of price increases in this segment specifically. So probably there was an assessment in purchases during the First Quarter this year.

On the following page, we can clearly see on the left-hand side we can see the performance of the Wood division and on the right-hand side the performance of the overall industry. The difference of the overall industry here in this slide when compared to the previous slide is that here we have the shipments of hardboard and also shipments of export market.

And the provision here is that the Wood division managed to grow or to outperform the industry as a whole. On a year-to-year basis the Wood division increased shipments by 16% as the industry grew by 15%. And on a quarterly basis we managed to grow close to 9% as the industry increased by close to 2%.

As I pointed out in the previous slides the business environment in this segment improved considerably. And more recently, what we see in this industry as positive is the implementation of the sak [ph] substitutions. Now the furniture industry is entitled to pay 1% of revenues instead of a 20% INSS tax on payroll.

Also the IPI tax over furniture was reduced from 5% to 0%, equalizing the condition of the furniture in the point of sale to the whiteline goods, including washing machines, drying machines, tanks, washing tanks and such products [ph]. More recently Caixa Economica, which is a state-owned bank, announced a credit line worth BRL2 billion to finance both furniture and whiteline goods with reduced interest rates between 1% and 2% and financing terms up to 48 months.

Following to that, on slide number seven we can see the consolidated performance of the Company; revenues increasing by almost 12% year-on-year. And a quarter-on-quarter basis of reducement of 4%. Our reading is because of seasonal aspect given against the First Quarter performance tends to be weaker than the previous quarters.

With regard to the geographical distribution of sales, the foreign market still represents only a small portion of the overall revenues. 96% is still being generated within the domestic market. And when we have the breakdown for a product, we can see that Deca achieved almost a 40% cut or stake in the overall revenues.

Following to that, we had the operating performance and now measured by EBITDA, an important improvement here. Again, when we analyze year-on-year we can see that EBITDA reached almost BRL210 million with the EBITDA margins of 20.3%. And if we consider that the cost base increased considerably on a yearly basis, we can still see an important operational improvement margins in the First Quarter. And that was almost -- was only 22.7%. So, this represents an increase of more than 500 basis points in the margins.

On a quarter-on-quarter basis, also EBITDA growing by almost 11% and also on a marginal basis 300-plus basis points of all what we posted for Q '11. Net income is representing here the improved operating performance year-on-year increasing by 12% and quarter-on-quarter by almost 9%, which brings the return on equity to 9.2%, above the 8.7% posted in the previous quarter and 8.3% in the First Quarter '11.

Following to that, we have on slide number nine the performance of the Wood division during these last five quarters; revenues increasing by 13% year-on-year, gross margin 31.5% moving only to third or quarter '11 and pretty much in line with the margins of the Fourth Quarter '11. All of that because of a best occupancy rate or better occupancy rate in our lines. So with a dilution of fixed costs.

Also the cost of the revenue [ph] reduced during the First Quarter '12, contributing to the improvement on the gross margin. We had some actions also geared to reduce costs in this division more linked to the reducement of personnel.

On EBITDA side this is translated in 20 increase -- in EBITDA of 24%. Again, the First Quarter '11 was very challenging because of the reducement of the inventory levels in the furniture industry and the changing operating market. But the conditions now more positive, more favorable for the furniture industry and, of course, we are taking advantage of such improvements.

When we analyze the result capacity and in capacity rates, we can see that MDF -- we managed to run the plants close to 80%. But the highlight here is the degree of occupancy rate in both MDP and hardboards above 90% occupancy levels. The cost structure we did it only formative just to show you that personage of the participation of resin here, which is more important in the composition of the cost of this division.

As an additional information this input that increased in cost in 2011 by 17% more or less year-on-year in the beginning of this year was down by around 10%. But in April is showing awareness a slight increase over March, around 7%.

In Deca we have on the top left-hand side the performance of revenues increasing by almost 10% year-on-year, gross margin almost 40% in the same levels of the first Q '11, the best of these last quarters. So, the performance improved considerably. When we analyze EBITDA we can also see a great improvement in margins bringing or arriving close to 27%.

The difference between first Q '12 and '11 in terms of margin is the higher cost base. I would like to remind you here that labor represents about 40% of the overall cost of Deca. And last year although (technical difficulty) negotiations with the local unions, were around or represented a salary increase of 70%. Overall salaries increased by higher than that or close to 11% because of the conditions -- the overall conditions in the employment market.

With regard to the capacities we can see that Deca is taking the advantage of economies of scale diluting the most of fixed costs because it went very close to 100% occupancy rate, which justified the investments that are going on this year.

Next page we have the debt picture. We can see that first Q '12 debt short term reduced by almost BRL100 million, when compared to the previous quarter. The overall debt is in line to fourth Q '11, BRL1.9 million. Cash position increased a little bit to BRL766 million, net debt BRL1.1 billion, representing 31.6% of the equity and only 1.38 times EBITDA for the last 12 months.

When we analyze the cash position against the debt amortization schedule, we can see that the situation is very comfortable for the Company. We have BRL766 million in cash and maturities of debt in 2012 of only BRL480 million.

When we analyze the origin of debt we have only close to 5% debt in foreign denominated currency, of which is fully hedged to reals. So, the cost of the overall debt is in reals.

Following to that, on slide number 12 on the top of this page we have a history of investments conducted in the Company since 2008. These figures are in reals, millions. We can see that in '12 we accomplished already BRL112 million worth of investments out of BRL650 million which are expected to happen during this year.

I discussed a little bit already. And what we are doing and here we can see by how much capacity is moving freely. In the Wood division again the investments are to bring the affected capacity of MDP to this 1.6 million cubic meters. This will be an investment done in the Taquari plant. And in MDF in new lines of MDF in [ph] Sao Paolo with an operation expected for the end of first half 2013. The second line is still on schedule and expected to end during '15 [ph].

In Deca we are growing capacity in both segments, metal and ceramics. In metals the investment is being conducted in Jundiai [ph] and the ceramics in the new plant of de man suchanil [ph]. Following to that, is just more information about these investments. So with Itapetininga it will be a MDF plant of 520,000 cubic meters a year with full capacity. MDP we will grow the effective capacity from 430 -- I'm sorry, the available capacity currently from 430,000 cubic meters to 600,000 cubic meters, which will be for to the effective capacity of this plant. And in Deca 2.4 million assets a year in Tujuri [ph] and 1.2 million end of the year Jundiai [ph].

With that I complete my exposure -- explanation of the growth, the performance to end the First Quarter and put myself available to the questions that you may have. Thank you.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session.

(Operator Instructions).

Our first question comes from Mr. Lucas Ferreira with JPMorgan.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Hello Alvaro. Hello, Flavio. Thanks for the call. My first question relates to your product mix for the Wood division. We saw very strong MDP sales concurrent to MDF. I was wondering if this is something that should continue to be seen in the coming quarters. And I'm trying to quantify or try to at least understand so and how this could impact EBITDA the margins because if I'm not being mistaken in MDF and MDP usually have slightly lower EBITDA margins if compared to MDF if this is true. This is my first question.

And second question on the pricing side just to understand where your prices stand versus your competitors. And coming back to the issue of mix if you could give this quarter, tell us how MDF and MDP prices evolved on a quarter-on-quarter basis just for us to try to measure this mix effect on your consolidated pricing. Thank you.

A - Alvaro Penteado de Castro {BIO 5537843 <GO>}

Just a second, Lucas. We are discussing here and we will address your answer. Let's organize the thoughts here.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Thank you.

A - Alvaro Penteado de Castro {BIO 5537843 <GO>}

Okay. Let's go. Well, as we pointed out in the previous call in Portuguese we address the market that we implemented already price increase in MDP effective now in April by around 6%. What happened is that currently the profitability of both segments are pretty much very close in the MDF. Okay?

So with regard to mix when we talk about second Q, both products have about the same profitability. When we analyze the performance during the First Quarter and we see that the capacity utilization more occupied in MDP than MDF, probably you have an anticipation, a slight anticipation of that acquisition of MDF. MDP tends to compensate the price increases that were announced by the end of the month of March and, of course, were effective in the beginning of April.

So probably you have an anticipation. And normally you would see lower demand for such products in the second Q. But this is not what we are seeing. You know that during the First Quarter the activity tends to be for the seasonality point of view weaker than the Second Quarter. So when we analyze the performance currently we see a normal second Q with the operating levels making us believe that we will be above the previous quarter.

When we analyze the competitive environment, speaking specifically about the competition and what we see is that they followed so far Duratex' movement. I don't have any other information showing the other way around. The market for an MDP is lighter than MDF and probably what we would see because the market is lighter today is a migration for of the industry to the MDF market making the situation a little better for this product in the coming months. Okay?

Q - Lucas Ferreira {BIO 16552031 <GO>}

Okay. Thank you, very much.

A - Alvaro Penteado de Castro {BIO 5537843 <GO>}

You're welcome.

Operator

(Operator Instructions).

Excuse me. Our next question comes from Mr. Lucas Ferreira with JPMorgan.

Q - Lucas Ferreira {BIO 16552031 <GO>}

And thank you for the follow up. And just to double check where you mentioned in the presentation and how do you expect your negotiations with the unions for Deca to evolve this year. If I'm not mistaken I heard 11%. Is this correct or what is the expectation? Thank you.

A - Alvaro Penteado de Castro {BIO 5537843 <GO>}

No. The negotiation was lower than that. But because the market is very demanding we had to provide some also summary clearances to give turnover on a normal basis. So when overall year-on-year salaries increased by more close to 11% than what we negotiated with the union. This year we expect salaries increase to be much lower than what happened in last year, probably be due inflation plus one, plus one and a half, no more than that.

Q - Lucas Ferreira {BIO 16552031 <GO>}

That's perfect. Very good, thank you.

Operator

Excuse me. Our next question comes from Ricardo Alvez [ph] with Morgan Stanley.

Q - Unidentified Participant

Hi. Good afternoon, gentlemen, just a question regarding margins. There was a nice improvement particularly in Deca to I guess 26%, 27%. And it's coming up a long way since the consolidation of Elizabeth. How far -- how much higher do you expect to be able to bring up the margins on the Deca side?

A - Alvaro Penteado de Castro {BIO 5537843 <GO>}

Hi, Ricardo. Thank you for your question. We have to remember that this margin reflects already the price increases that we implemented in the end of 2011. And with regard to additional cost pressure only salary increases in the metal fitting segment.

My guess since we do not have a this present moment any other price increases scheduled for the year at the present moment again. And we expect some inputs to grow at least in line with inflation probably this margin will not repeat in the coming quarters. Probably it will reduce a little bit. But on the positive side what I can tell you is that we have product mix improvement in the Elizabeth segment.

Probably it's like the Second Quarter this year we will be able to achieve already 50% of the output capacity of that plant already in a better market segment that we had in 2011, on the negative side inflation plus the commencement of the new plant in Caymados [ph] more toward the end of the year.

You know that to start a refute we have to hire people. We have to buy raw materials in order to start running the plants. And in the beginning, you have some inefficiencies in terms of margins -- operating margins. So all of that will be seen during the course of the year. Okay? Fair enough?

Q - Unidentified Participant

And Caymados [ph] is in the Fourth Quarter, or Third Quarter?

A - Alvaro Penteado de Castro {BIO 5537843 <GO>}

At the end of the Third Quarter, beginning of the Fourth Quarter.

Q - Unidentified Participant

Okay. And just one other question then, are you still seeing pressure from foreign competitors on the Deca product line?

A - Alvaro Penteado de Castro {BIO 5537843 <GO>}

Well pressure per se we haven't had. What we have are seeing is a threat, a threat that on the third and FX level is lower than the threat we saw in 2011. And this is one of the reasons why we were able to increase prices but also 7% during the Fourth Quarter. We still -- we are still following very close the movement of these foreign players in the export market. But we haven't seen anything that cause our attention -- shows dramatic change in consuming patterns or even in the import level.

Q - Unidentified Participant

Thank you, very much for that.

A - Alvaro Penteado de Castro {BIO 5537843 <GO>}

Thank you.

Operator

(Operator Instructions).

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

A - Alvaro Penteado de Castro {BIO 5537843 <GO>}

Well, thank you all for accompanying our conference call. Myself and my team we are here to clarify any other points and other doubts that you may have. Thank you. Have a great day.

Operator

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