Q2 2011 Earnings Call

Company Participants

- Alvaro Penteado de Castro, Investor Relations Manager
- Corporate Participant

Other Participants

- Analyst
- Augusto Ensiki
- Josh Milberg
- Lucas Ferreira
- Luis Vallarino
- Thiago Lofiego

Presentation

Operator

-- ladies and gentlemen, and welcome to Duratex Audio Conference Call. Thank you for standing by. At this time, all participants are in a listen-only mode. Later we'll 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 Penteado de Castro, Investor Relations Manager. Please go ahead, sir.

Alvaro Penteado de Castro {BIO 5537843 <GO>}

Hi. Good afternoon. Thank you for our accompanying Duratex audio conference. I will go through the second quarter results. Just to remind you, we released such results this morning before the market opened. And this morning also we released a material fact about the dividend, the interim dividend that will be paid starting August the 15th. We will distribute close R$60 million.

Turning over to the presentation on slide number two, we bring some highlights about both divisions Wood and Deca and highlights of the year of 2010 and the year of 2011. Starting on the Wood division. Last year, we started the year very strongly, overcoming the crisis effects of 2009. We also were very successful on the recovery of the price base, remembering that during the course of 2009, prices deteriorated around 20%. And talking on 2010, we started to push prices up, recovering such discounts were entered. And these movement also continued during the course of 2011, as I will discuss further in this presentation.

In 2010, the costs were in balance. We haven't experienced in that year any major pressure on the Wood division. And we had -- incentives on the revenue of incentives that went through the end of April. So, revenues in that year came very strongly in the beginning of the year, and after that the activity diminished in the industry as a whole.

The year of 2011 started weaker. The results of the first quarter show that, and the activity is picking up. The second quarter was much better than the first. We had a few reserve economies of scales, the margins we operated a great deal as we will see further in this presentation.

But, we still have a very challenging scenario due to the increase of the interest rates and some cost pressures on the system, specifically on the resin side and electric power. As you know, our contracts are paid to IGPM, so we had the best two of the IGPM on our cost. So, in the end, we saw demand at the same levels of the year of 2010.

On the data side, we started to feel cost pressure in 2010 already by the end of the year. In that year, we also had recovery on the price base. 2011, more cost pressure, specifically labor in corporate. And some highlights on the vitreous China segment. We were able to push more price increases during the beginning of this year, something around between 4 and 6%. We had the start up of a new field in the Pernambuco plant, a plant that we acquired in 2008 from Cerâmica Monte Carlo. And since then, we are investing in that operation following this trend on the construction segment in the Northeast region, which is performing quite well.

We also incorporated Deca Nordeste, which is the Elizabeth company that we acquired in February. It was renamed to Deca Nordeste and was incorporated into Duratex recently. And we had of course the effect of this incorporation, bringing more people, sales mix which is more oriented to the more economic segment in to data bringing up intriguing to push margins a little down as we will see in this presentation. But, an important acquisition, contributed to expand the capacity of Deca Ceramics by 25%. And cost us only R$80 million.

In metals, we are more interested or more focused on cost management. This year, we see more risk of import competition. So, we are preferring to address the cost issue instead of increasing prices. And we also had the start up of our new developed plastic equipment that will contribute to enrich the sales mix, help us to ship more finishing goods in the future. These equipments is inserted into that macro plant to push capacity to 18.2 million items a year until the end of this year.

Slide number three, we start talk about the scenario. And if I may add an uncertain scenario as we will see. We have some positive events going on here as we can see unemployment rate in Brazil going down, is one of the lowest levels at 6.2% in June. We see the increase of the minimum age contributing to increase the disposable income. We have credit over due in one of the highest levels, which is contributing to the performance of the overall Brazilian economy.

But, on the other hand, we have some negative aspects of economy. The first one is interest rate, which is going up. Recently in July, the Central Bank increased the rate to 12.5%. And although, this sort of rate is lower than the rate that we had in the past, it is still very high, specifically when we talk about the real interest rate, which is around close to 7% this is bad for consumable goods. And in our region, it is impacting more the Wood division segment, which is what exposed to this sort of short-term event. The consumer confidence index, which started to increase in June, it is still on lower levels that of those of 2010. And on the on the slide number four, we have the food basket and minimum wage. And here the 60.2% shows how much of the minimum wages consumed with the food basket in the past 70%, now 50%, and the difference is 20%.

So, you can see different signs, something good, bad, which has to be on certainty of this scenario that we see ahead of us. Slide number five brings some information about the building industry. We have a selection of companies that is displayed in the bottom. And we can see, the net revenues of these companies and the number of launches in real terms.

This is a material from Credit Suisse, even if we think this is too bullish and cut by -- this industry showing resilience in the market. We still see the availability of credit, we still the terms to finance real on good terms, and the performance is showing that, expected growth around 20%, around 20% revenues amount.

As you see in data, it's pretty much aligned, revenues increasing in strong basis, volumes also, and it is aligned.

Slide number six brings more diverse information about inflation. We can see on the left hand side that developed economies are experiencing a weak growth and an inflationary environment. On the right hand side, we can see the developed economies, emerging economies showing growth and inflation. Right hand side, we can see that in Brazil, inflation is coming down, probably as a result of all of these market potential measures. The average of expected inflation for the rest of the year, of the second half of the year is on lower levels than the inflation in the first half of the year, but still with a very uncertain scenario. If we see in the bottom, we can see some relevant events that are going in the world. U.S. with this challenge of negotiating debt ceiling, the euro zone with all those sovereign debt issues, emerging economies with inflation. So, the scenario is very complex right now as we speak.

Turning the page and bringing the discussion more to Duratex operation. We have the scenario wood panels. We can see how demand evolved during the years for MTF, growing on strong data, almost double folding the shipments between 2010 and 2005. But, on a semester basis, first half 2011 and first half 2010, we can see that demand was pretty much flat, and the same thing happened for the MDP for the MDP segment. Probably, we have some explanation for that of course. The first one is that 2010 started very strongly. As I mentioned before, we were overcoming the effect of the crisis of 2009 with tax incentives and so on. So, the comparison basis is very strong.

But, the good news is that, during the second quarter, we had a strong volume growth that contributed to the dilute the fix cost, specifically in our case. And we will see this further in this presentation. We bring some information here in the footnote. Available effective capacity, 3.6 million cubic meters for MDF. This is what we leave is the available capacity during the first half for the whole industry, due to plant stoppages for maintenance and some investments that are going on still. The effective capacity though is 4.2 to 4.1 million cubic meters as we were disclosing before.

Slide number eight brings the Abramat index. For those of you, who are not very acquainted with this index, it measures the revenue of the building material industry in the internal market Brazil. And here, an important information is that, this Abramat index was downgraded from an expectancy growth rate for this year of 7% and expectancy that released around March to 5% more recently. And these are lying probably with these market potential measures that are effective in the market.

Following that slide number nine, we are still showing our numbers before and after IFRS to do a more transition for you to be more acquainted with everything that changed in our case. In this slide, we have information, the reconciliation of both assets and equity. So, starting with asset, before the adjustments to IFRS, we had R$5.5 billion as of June 30th, they are adding business combinations R$744 million. Just to remind you business combination is -- was already with association between Duratex and Satipel. Satipel was entered into Duratex, with a goodwill and this the R$744 million that we see here.

Biological assets come from the mark-to-market of our forestry assets only no land, but the forestry assets were mark-to-market. And employee benefit is linked to the surplus of the pension fund of ours. In total, the assets increased by $R1.1 billion, representing a 12% increase over the base of pre-IFRS adjustments to R$6.6 billion.

On the equity side, the same events, business combination increased equity by close to R$550 million, biological assets are contributing to increase equity by R$250 million, employee benefit linked to the pension fund surplus at R$46 million.

In total, equity ended June from the June under the IFRS basis at R$3.5 million. This increase is important to understand all of those events our non-cash events. But, it is contributing of course to diminish the returns under this new accounting methodology. But, basically, the return on equity of course was impacted because of this change on the accounting methodology.

Following next page, slide number 10, we have the leverage of the company, it's still very unleverage. We can see that a short-term debt is around R$530 million, long-term R$1.4 billion, in total R$1.9 billion. We have on cash or we had on cash by June 30,R $759 million more than the short-term liabilities.

Net debt R$1.1 billion, which corresponds to 32.8% of the equity and 1.31 times the EBITDA for the last 12 months. If we see the characteristics of this debt, close to 6% is originated in foreign currency and the majority on reals, domestic currency. Amortization scale is very comfortable, we still have or we only have R$260 million to amortize during the second half of this year. As we have on cash against that R$759 million.

Following to that, we have the reconciliation of the net income. We will start on the first table after the adjustments to IRFS. So, we do a reconciliation, we start with gross profit... these are the highlights. We had a gross profit of R$253 million, the operating profit before the financial results R$143 million, income before tax as 111 and the net income R$100, 30% above net income for the first quarter '11.

One highlight here is that these are 100 million were benefited with extraordinary events linked to the revenue of one farm of our close to São Paulo. These revenue increase are contributed with R$9.2 million in the formation of the net income. So, if we take that off, the recurrent net income was R$91 million corresponding to 10.3%.The performance is much above of that one that we presented during the first quarter, inline with what we said during the call of that quarter that activity was picking up, was improving. And we were expecting the results to grow considerably, which happened.

On the year-to-date base however, again that one quarter as the first quarter of 2010, the activity was very the heated, the momentum was very good, a lot of incentives, cost more lower levels than what we have now, which helps explaining why results decreased by 11% on a year-to-date.

On a cumulative basis however, when we analyze six months 2011 and 2010, we can see that the results are pretty much inline, R$168 million, R$171 million a year ago, and return on equity close to 10%.

The table low shows the reconciliation before the adoption of IFRS. The main difference here is that, the profit sharing and the stock option program, they were below the operating line. And this is the major the difference on the operating side. So, when we analyze EBITDA, this profit sharing and stock option, they are below the operating line.

Following to that, slide number 12, we have revenues how it was generated. On second quarter revenues total R$751 million, almost 14% above quarter ago, and 5% close to 6% above the revenues for the second quarter 2010. Where or how this revenue was formed? 4% in the foreign market and 96% in the domestic market.

Consolidated revenues, we can see that Deca contributed with 36% on the formation of revenues as the Wood division 64%. Following page, we do the reconciliation of EBITDA. Here, we start with the operating profit before the financial result of R$143 million during the second quarter. Then we add back the depreciation, amortization and depletion of R$75 million. We take off the effect of the mark-to-market of the forestry asset, we take off R$27.6 million, and we have to add back the depletion correspondent to such mark-to-market, which is close to R$36 million. And also the employee benefit and this two events back to the IFRS non-cash events. So, did regard such events getting to EBITDA of R$225 million, EBITDA margin of 30%. Again, second quarter we have this benefit of the revenue of the farm R$40 million, we have to pay that out to get to the recurring EBITDA of R$211 million or 28% EBITDA margin.

We can see improvement over the first quarter '11 in terms of margin and on nominal terms of course the EBITDA increasing by 16%, and pretty much aligned with the results posted on nominal terms 2010, a slight decrease on the margin. Following to that as I mentioned before, the main difference between IFRS and before IFRS when we talk about EBITDA is profit sharing as stock options that in this case before the IFRS, we have earned the operating line. So, EBITDA is a little higher than the previous one that I discussed. But still, recurring EBITDA at R$270 million with an EBITDA margin of 29%. Just to remind you, IFRS, the margin was 8.2.

Following to that, on slide 15, we have the performance of the Wood division. Here we can see, shipments growing by 12% quarter-on-quarter. On a yearly basis, pretty much stable of 582,000 cubic meters against 519 in the second quarter 2010, 1.4 million, 1.2 million when we see the numbers on a cumulative factor. The reconciliation also of the EBITDA, we can see the operating profit before financial results R$90 million, we take off the fair value of biological assets add back the depletion correspondent to that, add back the depreciation, amortization and depletion, take off the employee benefit. So, we get to give the R$160 million, up 33% EBITDA margin, but with the extraordinary events. When we take that off, we have recurring EBITDA 145 and margin of 30%, so we're back on the 30% level. One thing that contributed definitely to bring margins up from the first quarter was economies of scale, and shipped 63,000 cubic meters more than on the first quarter, diluted further -- and we also implemented some price increases during the second quarter, and we have already the marginal effect of such increases already in the second quarter. The full benefit will be more seen during the third quarter 2011.

Following to that, we have some more information about the Wood division, the installed capacity and the occupancy rate. Here this occupancy rate was measured against available capacity. You can see on the table on the right hand side, you can see that available capacity, which is considering all the events stoppages and everything that happened that decreased a little bit than effect capacity that we also show in this table.

So, this occupancy rate was measured against the available capacity. So, MDF we posted our 79% occupancy rate, MDP 82 and hardboard 96. In terms of shipments, we can see a evolution quarter-on-quarter and on a cumulative data, we can see that the year of 2010 started very strongly, and then the activity diminished a little bit towards the end of the year. This year, the activity started more weekly, and is picking up. If everything goes on a normal basis, most likely the second half of this year in terms of shipments will be above of what we posted in the first half. And if we check the shipments pattern of 2010, we will see that these shipments were pretty much risen between the first and the second half of the year. And this might not be the case during this year.

Next page slide 17, we have the same information about data. We have the reconciliation of the EBITDA, starting on the operating profit before the financial results R$53 million. We add back depreciation R$30, take off the employee benefit correspondent to data to get EBITDA of R$66 million, EBITDA margin of 24%. All the extraordinary events happened in Wood. So, this is the result of backup. One highlight here, and one of the reasons why we had so much reduction on the EBITDA margin is related to some events that took place in the second quarter. I like to remind you that we incorporated Elizabeth, the company that we acquired by R$80 million. It was fully, or the effect of Elizabeth was fully accounted in the second quarter, and partially on the first quarter. Elizabeth still has a mix, a sales mix which inferior to the one of the Deca as a whole. It is a company that was more oriented to the economic segment. And from now onwards, we intend to improve the new business mix, bringing the operation more close to the DNA of Deca, more oriented to mid and high in income segment.

We also had the start up of a new Pernambuco in the unit that we acquired from Cerâmica Monte Carlo in 2008. Of course, that when you have a start up of an equipment like that, you have more people, and not necessarily the necessary output to overcome this extra cost. So, we had some inefficiencies in the beginning, inefficiencies that will diminish from now on.

Also on the cost side, copper is still in a very high level. We didn't get the benefit of the real appreciation, neither stronger slight reduction on the position, international position of copper. We didn't have that benefit, so we still have this input pressure in our cost. And we had also some commercial expenses that are inflated with inflation. We always have these sort of events, but they are more expensive to the -- one of inflationary indexes of the debt.

In the end, or one highlight that I'd like to make, although we had a reduction on the margin side, when we look the cumulative data for the first half 2011, on nominal terms we had more generation of cash. We generated R$138 million, against 130 in 2010. So, the overall EBITDA is increasing. Deca is pretty well positioned. You can see in terms of shipment, this operation is resilient, shipment increased on a quarterly basis by 9%, year-on-year close to 6% and on a cumulative data six month year-on-year increased by 12%.

Following to that, we have the installed capacity and occupancy rate, this was China 89% and metal fittings 93%. You can see the shipment pattern, second quarter 2011 was a record in terms of shipments -- overcoming the best record second Q 2010.

We have nine plants currently. We are the most diversified player geographically speaking, with plants in the South, South East and North East, now, with two operation. I'd comment this further presentation. But, right now what we are have going on in terms of CapEx is, in metals, we are expanding our site -- which is located in the -- of São Paulo. We are still investing in Rio de Janeiro to start up this plans that we acquired in 2008 from Ideal Standards and with a change in the previous plan. First, we expected till reopen this site with the capacity of 1.9 million items a year worth of capacity. And now, we're talking about 2.2 million items a year worth of capacity. And in the North East, we just finish this expansion with the Pernambuco with the capacity 800,000 units a year. And we should start shifting the sales mix of the unit in Paraíba. that we recently acquire to something on higher segment in our income statement.

Following to that, the CapEx on a consolidated basis, you could take into account what we expect to spend during 2011. We are talking about R$2.9 billion in these last five years. During the first half of this year, we spent something like R$343 million, including the down payment for the new MDF lines that I will comment in the next page. And we still have estimated for the remaining of the year R$456. The distribution of the CapEx, the Wood division accounted for almost 39%, before Forestry division 18% and Deca 42%.

Next page, we have the information about the new MDF lines. Just to remind, we announced two lines to be implemented between the years of 2012 and the end of 2014. The first line is to be implemented in our Itapetininga unit, in the state of São Paulo. We're talking about 520,000 cubic meters per year line that will be installed in this unit, where we also an entity plans. So, it will be a complement, we will have a complementary MDP plus MDF in the same site.

As I said before, we did the down payment already, we're already in the range received the building that we can see this picture, the scheme of where this line be installed, which is in the right hand side of the slide. And this building started away. The second line with the capacity close to 680,000 cubic meter is effective. We haven't announced yet the location of this site, because we are negotiating with the municipality to see what's that toward in terms logistics, in terms of mark-to-market assessments. In total, we expect to spend R$1.2 billion in this two line, which include also some 14 facilities. As I highlight, in the second quarter 2011, we inaugurated two important equipments in the Wood division, one of them to do more low pressure finishing, aggregating more values to the sales mix of the Wood division. And we also commissioned a new capacity of laminated flooring, following or pretending attend this growing demand coming from the building industry.

In the bottom, you can see how the capacity adhere our nominal, we're talking about nominal capacity, how the nominal capacity evolved during the years since 2007 and until 2015 after the completion of this expansion that I just commented. We expect nominal capacity to reach 5.3 million cubic meters by 2015, which represents more than a 100% growth over the seven year period. On a compounded annual growth rate, the capacity is growing by 13% a year.

Following to that, we have the same information of some highlights about the Deca division. We can see how the capacities are evolving during the years in the same timeframe, growing from 18.2 million items a year in 2007 total capacity to 30.4 million items a year in the beginning of 2012. This growth when we assesses the ceramics is pretty impressive. We're growing more than 200% the capacity in ceramics. In 2007, we were second runners in the domestic market. Right now, we're leaders within this segment, likewise in metal feedings. In both segments, we should have something around 40% market share.

With regard to the investment itself, we can see that Deca is receiving investments of around R$430 million, in the, ceramics we are increasing capacity by 1.8 million items a year, with the acquisition of Elizabeth that took place now in February. And again, this increase in represented -- increase over the existing capacity by then. We recently inaugurated this new Cabo de Santo Agostinho which helped to contributed increase capacity by 800,000 items a year. And these came out of those project that right now, I said before, 2.2, sorry, it's 2.4 million items a year, the correct capacity that we are adding when we start up this new project. The previous estimation was for 1.9 million, so we are increasing by 500,000 items a year this project.

In metals, we're also increasing capacity by 2.4 million items a year between the years of 2011 and '12. These investments should be concluded by the end of this year, beginning of the next year. And in the bottom, we have the highlights of this project of --.

Following to that, -- an investment, we also have a clear position in terms sustainability of the business. In terms of the Forestry assets or the Wood division, we have all our certified wit the Greenfield ISO 14001. And remembering that we were the first company in Latin America to receive the Greenfield, and we're talking about the year of 1995. We have products here for which water stabling devices in Deca. We call this program Deca Pura. Products that sometimes help reduce the water consumption in 80, 60%, depending on the product.

We have also some products with the system -- label -- these products have expected in green building construction, which is becoming more constant to see construction, that has to follow such standards of more sustainable sort of construction. On the timberland side of the business, we have something closer to 129,000 hectors of land of which 160 hectors are planted for us.

One highlight here is that we are planting almost one tree per second. And if we see this how the yield per year increased in this last 50 years. In the beginning of the 60s, we had a productivity of 20 cubic meters per acre a year and in 2010, we were talking already about 52 cubic meters per acre year, this increase obviously is important, because as we expect capacity, we depend on less investments in land. This increase in yield of course contributes, and will contribute to fulfill the wood necessity for the investment that we are conducting in the Wood division. Those two plants of MDF, they are... they will be erected with no necessity of further land acquisition, at least to fulfill their wood requirements, because increase of yield, we'll supply the necessary wood for these plants when there operation.

Following to that, on the same line of the sustainability, we released 2010 annual report this time following the standards of GRI Level 8, just to remind you. Till then we follow the Level 6. So, in terms of disclosure, we advanced -- and we submitted these reports to the Global Reports Initiative to validate it. So, our report was validated by these people, which shows the consistency of the information provided with the standard requirements for Level 8.

Slide 24, we start closing this presentation with corporate governance. Here, we have the picture of the major shareholders group. Of course, the controlling group Itaúsa and Ligna, Itaúsa was almost 40% and Ligna almost 18% stake on the company, following to those two controlling groups, the other highlighted, the participation of foreigners in the company with a stake of 27%, followed by local players 12%.

We have our share listed on Novo Mercado, meaning that one share is correspondent to one vote on their families. We have a pre fold 42.6%, a dividend policy worth 30% of the adjusted net income just to remind you this is all the minimal dividend required by law, which is 25%. And our Board of Directors composed by nine members, three of which independent. And just to name those, we have Alcides Tápias, who is a former Minister of the -- and also former CEO of Camargo Corrêa Bradesco. We have We have Fabio Schvartsman, which is currently the CEO of and our CFO of Grupo Acucar and COO of other companies, and Alfredo de Souza, who is the former CEO of Citibank Brazil. We're part of -- and have our shares also traded or composing the ISC, which is index of --.

Next slide shows the value creation into tax, seems the announcement of the association with such which took place in June 2009. They saw gain to 111% as legal -- increased only 21% -- this period. The -- by the end of June was -- and that was pretty much what a I had to tell you.

Now, I put myself available for 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. Nicolai Sebrell with Morgan Stanley.

Q - Analyst

Hi. Just talking a little bit about your cost, talking about the resin, why was the resin in the large part of the or at least significant there is a reason for cost pressure in the quarter? And did your resin supplier imported or is it mostly domestic? And if you could talk a little bit more about the outlook for pricing, you made the interesting comments that you guys would like to or prefer to focus on cost control rather than trying to price through cost inflation. I was wondering what's behind that? And then I have a follow-up after that if you don't mind.

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

Hi Nicolai. This is Alvaro. Thank you for your question. With regard to the cost resin, resin is used in the Wood division, together they wood particles and fibers, it is what gives the strength of the --. These resin manufacture with mainly two -- one of them is urea real and the other one is methanol.

Urea is acquired locally for -- think is major supplier of this raw material. And the other one is methanol, which is imported from Chile, and mainly from --. These raw material increasing price on a yearly basis around 16% first quarter 2010. And on the second quarter, we had a slight decrease in the course of this raw material, something around 3% decrease.

On the other hand, we had other cost that increase, for example, electricity power. We started to have the effect of the contract that the testing of the IGPM on the quarter starting on the second quarter this year.

With regard to the pricing outlook, we started to increase prices before than we expected inline with the speeding up of the market that we saw in the second quarter. So, we took the advantage of that based on some price increases, and the Wood division, they were around or between 6 and 8%. And in Deca, in is ceramics specifically between 4 and 6%.

Metals, we are not -- specifically because we're preferring to address cost, include the cost management within the division not to open to much the market to the imported goods. We feel more threat of imports in metals and we want to safeguard this segment.

With regards to the future, further price increases will depend on the market by then. If we see the opportunity, if the market is accepting, we'll try to compensate these cost pressure, which is common to everybody in the industry. But, this is to soon to say, we do not use to anticipate any discussion about future price increases, but first we like to talk to our customers first.

Q - Analyst

Okay, understood. And if I could quick admin question. On page seven, you have the effective capacity for yourself and then the effective capacity of the industry. I assume the capacity that you list for the industry, for example in MDP its 4 million cubic meters per year. That's excluding yourselves, is that correct to get the whole on the entire industry with yourself is be adding 3.6 plus 4?

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

No. Actually, the 3.6 and 4 they are with the same capacity. I mean everybody is in... Duratex is in and all the competition is in. The difference between 3.6 and 4 is that in 3.6 we are considering the effective capacity during the year taking into consideration plant stoppages and some investments that were not made yet or they are undergoing. The 4 million take into consideration, all the available capacity out there all the investment and everything.

Q - Analyst

I understand. Okay. That's very clear. Thank you.

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

You're welcome.

Operator

Our next question comes from Mr. Thiago Lofiego with Merrill Lynch.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Hi. I have one question. What is volume -- for this year for both divisions? And also if you could give us some color on how the month of July was?

[Technical Difficulty]

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

Hello, Thiago?

Q - Thiago Lofiego {BIO 16359318 <GO>}

I don't know if you heard my question.

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

No. There was something, something going on here... I just.

[Technical Difficulty]

Q - Thiago Lofiego {BIO 16359318 <GO>}

Alvaro, can you hear me?

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

Now I can.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Okay. So, question is about your volume expectation for this year, for both divisions. And also if you could give us come color on how the month of July was, how your orders for August are looking? Thank you.

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

Okay. What we expect in terms of volume is, what I said before. The wood division should post better performance in terms of volume during the second half of this year. Our expectancy is for our growth around 5, 6%. As in Deca we will grow probably something around 15% or so. With regards to the performance of July, July is pretty much aligned with June. You have to remember that July is we have holiday. What kind holiday season, here, school holiday. So, it's not one of the best months. So, August will be an important month to see the trends for the quarter optimistic. We're optimistic, but still the scenario is very challenging.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Okay. So, you're adding, noticing an increase in your order book for August or that's just an expectation?

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

You remember that in our case, we have concentration of revenues towards the end of the month. So, whatever is turning right now is normal, it's turning as we expect, inline with the sort of growth that we expect for the year. But, we need to time we need to move towards the end of the month to see how the market is really, because of this concentration we have.

Q - Thiago Lofiego {BIO 16359318 <GO>}

Okay. That's great. Thank you, Alvaro.

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

You're welcome.

Operator

Our next question comes from Mr. Lucas Ferreira with JP Morgan.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Hi, Alvaro. Good afternoon. Tell me, if you're -- going forward asking most of your CapEx for this year I think 60% of this CapEx happened in the second half, right? So, how do you see your leverage going forward for next couple of months in the fourth quarter as well? And if you can comment on models and projections, what is the top leverage you find in terms of EBITDA given the extension you're implementing? Thank you very much.

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

Thank you for your question Lucas. With regards to the leverage, in terms of participation of EBITDA and equity, it should not change much. We expect from the second half... in the second half of the year to increase leverage by around R$200 million. We have still some MDF lines standing approval, and these lines are attached or correlated with these estimates, specifically in MDF, and some of them in Deca. So, in terms of leverage, if we do not do anything different from whatever is known by the market, leverage should not change much. Okay?

Q - Lucas Ferreira {BIO 16552031 <GO>}

All right. thank you.

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

You're welcome.

Operator

Our next question comes from Mr. Josh Milberg with Deutsche Bank.

Q - Josh Milberg {BIO 2004065 <GO>}

Good afternoon, Alvaro. My question relates to... I have two questions relating just some of the prior questions, just with respect to this growth outlook of 5 to 6% that you think is still achievable for the year. To get there, it seems you would need more than 15% year-over-year growth in the second half. And I wanted to know, are there any other factors beyond the S&P issue that you highlighted that would justify the expectation that this year the second half would be much stronger or in other words, have a much higher proportion of the total sales than what we saw in 2010 when as you indicated they were pretty even?

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

Hi Josh. Thank you. Well with regard to the growth outlook, well this expectancy is on a high numbers, okay. This is what we have right now. Of course that something that is very difficult to measure is the impact of the price increases and volume, okay. We know that whenever we increase prices we have a negative effect on volume shipped, sometimes we lose a little market share in the very short-term. The competition follows such price increases.

By the way, these last price increases we implemented was already fully accompanied by the other competitors. So yes, it's challenging in the second half to meet this expected growth in terms of volume that I just mentioned.

With regard to the reasons why that we believe that the second half might be better than the first are some. The GDP growth for the year was marked down. Currently is around or between 3.5 and 4% a year. And this growth will happen in the second half, because as we know the first half was not so much demanding, the economy was not very demanding for everybody, so most likely this quarter GDP growth will be achieved with the performance of the second half of the year and likewise we expect in our case, through our company this sort of growth, remember that we have some correlation with GDP between two and three times, and that might be the case during this year.

Another comment is, if you see this, the patten of demand in -- sense specifically with the division, you will see that it started with 560,000 cubic meters if I am not mistaken, second quarter 590 and decelerated to 560, 540.

Either way, the performance was pretty much even between the two semesters which is something very unusual to have and if you recall the second half of last year, we had some problems, when we talk about the debt, third quarter we inaugurated the SAP system so there was some effect in terms of missing revenues in the third quarter, and though in the fourth quarter with the start of the implementation of these market prevention measures the activity, the economic activity decreased a great deal, not only to Duratex, but overall, the market really felt those measures in the beginning.

And this year we see the other way around, the year started with this market prevention measures impacting great deal the market, and now we see, seems accommodated, we see that the ability of credit in the internal market did not change the cost of this debt did not change much, so the market conditions to achieve this sort of growth I think there is two -- and but we will -- we have to wait and see, if we rise or not, but we need that.

Q - Josh Milberg {BIO 2004065 <GO>}

Okay, that's very helpful. And I mean just following on that, my second question relates to CapEx, this better scenario that you describe doesn't materialize because of a weakened macro picture or otherwise can you just talk about how much flexibility the company has to slowdown some of its investments in the new lines, the new channel lines or otherwise, to respond to a potentially weaker environment?

A - Corporate Participant

Yes, we have the possibility of postponing the second line. We can't push to one year after the scheduled entrance of it. But if we check the market, ahead of us. Nothing changes, I mean we are talking about the second line entry, in fact 2015 we are talking four years from now, and I guess that the market itself improve.

Q - Josh Milberg {BIO 2004065 <GO>}

Yeah, okay. Thank you.

Operator

Our next question comes from Mr. Luis Vallarino with Citibank.

Q - Luis Vallarino {BIO 15049752 <GO>}

Hi, Mr. -- thanks for the call. I have a couple of question, maybe get some more granularity with your prior business. When will this price make on the wood and on the ceramic business? And maybe just confirm also that in order to get these kind of very strong volumes during second half. Then, what is the current expectation or the current possibility, given the current information you have of another price increase for the -- around the world, responsible through to -- in order to achieve in the first and in second half. Thanks.

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

Hi Luis. Thank you for your question. Well, the price increases implemented in different months in MDP and hardboard we pushed price increases close to 8% in April, then we may, we push price increases for MGS on the same basis. Several mix, we increased on April as well about 4% or between four and six, some lines increased by six, some others by four, maybe on average the price increase was 5%.

Looking forward again, we don't disclose future price increases, what we see is that these cost pressures that are hitting us, they are hitting everybody in the industry. So we expect that in some point or sometime in the future, the industry will stand to compensate these via prices, it's difficult to say if it is going to be on the second half this year or if it will be during the course of next year.

What is, what I know is that there is a movement or an effort to compensate these cost pressures via model, via prices. And again, if we raise prices, of course that we have to consider the set bond market share because we are in these vast movements of price increases do have backlash. So during these leading movement there is a trading in the very short term, volume via prices. Okay, meaning we might lose market share.

Q - Luis Vallarino {BIO 15049752 <GO>}

Thank you, Alvaro. And I have a second question. This is regarding your, the second plan that is still yet to be decided. And whether -- are you seeing what a possibility of some of the new projects from competitors in industry. If you're seeing any potential for this project to be canceled, what is your view or are you sticking with the execution of -- of new factory coming on-stream next couple of years.

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

Yeah, the capacity there are entering the market in the short run with us, are -- and this size is ours. I don't see any possibility of canceling the second land, not at all, what might be the case is, we have a dramatic change in the macro environment that shifts the function that we use to announce income tax we might go forward but not cancel, I don't see that happening. If we're talking about GDP growing around 4% a year, I think the announced capacity, our -- competition they should enter the market of course provoking some challenging short-term, but the market should absorb them in two years time after the entrance of them in the market.

Q - Luis Vallarino {BIO 15049752 <GO>}

Great. Thank you, Alvaro. Thanks so much.

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

You're welcome.

Operator

Our next question comes from Mr. Lucas Ferreira with JP Morgan.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Hi, Alvaro. Thank you for taking question. Just few quick questions on wood volumes. First, where are the volumes -- where are consumer inventories ran up, if inventories are at low levels and now you see from the stocking in the next quarter for say to just in balance levels and you would expect, we should expect inventories to continue at the same level next quarters. And second, we see the response in market share this year and maybe last year, as we try to reverse that trend of moving share any time soon? Thank you.

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

Thank you. We saw a reduction of inventories in the furniture manufacturing chain. More specifically in the first quarter 2011. Right now what we see is that there is not a movement of reviewing these inventories, I think the industry is working on lower inventory levels due to this growing uncertainty that we have on the market.

With regard to market share, currently probably we have something around 35, 36%; out of our capacity more close to 40. We are more or less prices than volumes. So this is really acceptable. Looking forward, we will trade more or not, I don't know we keep them. We have to wait a little bit more to see how the market is.

With regard to the new capacities. Again, if everything goes right, these lines that have been announced in two years, three years time, they should be taken and the market is firm. We see GDP growing on a sustainable basis around 4% a year, in this scenario, this interest or the demand for this market should grow double-digit, 10 or 12% a year, it is feasible and the assumptions for such investment is based on that or partly it is based on that.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Great. Thank you very much.

Operator

[Operator Instructions]. Our next question comes from Mr. Augusto Ensiki with Morgan Stanley.

Q - Augusto Ensiki {BIO 15988025 <GO>}

Hi, Alvaro. Just a question a little bit numbers that you show for the wood segment. I think this is the first time that you're showing the available capacity number next to the -- how long and what's necessary for you to reach that, net effective for the available capacity to reach that effective capacity?

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

Thank you, Augusto. The difference here is, when we talk about effective, this effective was estimated for the full year, okay. Full year taking into account mass stoppages, introduction, an estimation of -- the available, we re-calibrated the effect, taking into account that during the first half of the year. This actually went, we see the grand stoppages. So it's basically the same information, but taking into account the stoppages during the period. Okay. So the effective 1.5 was not all there during the first half of the year, it was 1.4 only, you see. Did I make any sense?

Q - Augusto Ensiki {BIO 15988025 <GO>}

Okay, but so then the number that you for example in the first quarter presentation those are off...?

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

Those are effective. Those are effective, if you want to do the comparison between first quarter and now, use the effective. Okay?

Q - Augusto Ensiki {BIO 15988025 <GO>}

Okay. So then in that case, your utilization based on the effective is somewhere, instead of the 80, it's somewhere...?

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

It's around that.

Q - Augusto Ensiki {BIO 15988025 <GO>}

Okay.

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

Okay.

Q - Augusto Ensiki {BIO 15988025 <GO>}

Okay. And so, I am sorry, but...

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

That helps explaining why we increase prices because the occupancy rate was higher than we anticipated.

Q - Augusto Ensiki {BIO 15988025 <GO>}

Okay, thank you. And one quick follow-up question. If you can just tell me a little bit of what was behind the lower taxes this quarter? I know there was like a deferred tax gain, if you can tell me what drove that gain?

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

Probably it's interest on capital that we declared on the second quarter, registered on the book of the second quarter and the payment, the cash payment we'll be now starting August the 15th is the only thing different that we had.

Q - Augusto Ensiki {BIO 15988025 <GO>}

Okay, so then you booked that tax gain when you announce them and then the cash...

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

When we register on the book here, so this is when we recognize.

Q - Augusto Ensiki {BIO 15988025 <GO>}

Okay, great. Thank you very much.

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

You're welcome.

Operator

[Operator Instructions]. This concludes today's question-and-answer session. I would like to invite Mr. Alvaro de Castro to proceed with his closing statement. Please go ahead sir.

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

I would like to thank you all that accompanied our conference call, I have put myself along with my team available for the further questions that you may have. Thank you very much and have a great afternoon. Bye, bye.

Operator

And that concludes the Duratex audio conference for today. Thank you very much for your participation, have a good day and thank you for using Chorus Call.