

Q2 2015 Earnings Call

Company Participants

- Flávio Marassi Donatelli
- Guilherme S. Souza e Silva

Other Participants

- Karel Luketic
- Lucas Ferreira

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen, and welcome to the audio conference call of Duratex. Thank you for standing by. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions to participate will be given at that time. As a reminder, this conference is being recorded.

I would now like to turn the conference over to Mr. Guilherme Silva, IR Manager. Please go ahead, sir.

Guilherme S. Souza e Silva {BIO 15325478 <GO>}

Hello. Thanks, everybody. Thanks for calling Duratex second quarter results. I am Guilherme Silva, IR Manager of Duratex. And the idea today is to discuss the results of this second quarter 2015. So first of all, let's move to page number one, and the idea here is to discuss the highlights from the second quarter. So the main one is EBITDA margin. So the consolidated EBITDA margin increased from 21.4% to 21.8% in the second quarter when compared to the first quarter 2015.

Point number two is regarding Deca. Improvement in the product mix increasing EBITDA margin from 18% to 20% in the second quarter.

Point number three, we have to highlight from the Wood Division. The increase of 7% in price as of April and growth of 18% in export volume in this semester when compared to the first semester 2014.

And the last one is regarding Corona. We signed DuchaCorona acquisition contract on July 1, completing the acquisition of the Corona.

FINAL

So, turning to page number two, and here, we will discuss the financial highlights consolidated of Duratex in the second quarter 2015. So the net income in the second quarter was R\$965 million. This amount is a little bit higher than the same period of 2014. Below, we have the breakdown per division. So the net income of Wood division Brazil was R\$545 million. This amount is a little bit lower than the same period of 2014. As a highlight, we have the net income of Wood division Colombia, Tablemac that increased more than 25% in this quarter. The net income was at around R\$84 million. And finally, the Deca net revenue was R\$336 million. This amount was very similar of the same period of 2014.

So in the picture below, we have the breakdown per division. So as you can see, 56.5% of the net income in the second quarter came from the Wood division Brazil, 8.7% came from Tablemac, and the rest 34.8% was coming from Deca division. In the picture beside, we have the percentage of the domestic market that represents 85.5% in the second quarter and the export market that represents 14.5%.

So it is important to mention here that we are increasing our export market participation in the net income of Duratex over the last quarter. In the end of 2014, the export market represented at a time only 10% of the net income. In the first quarter, the export market represented at around 12%, and right now in the second quarter, the export market represented 14.5%. This important part of our strategy should increase revenues out of Brazil, through exports and business out of U.S. (04:05) Tablemac in Colombia.

So turning to the page number three and we've got here the financial highlights consolidated of Duratex in the second quarter. Turn to picture number three, regarding the volume of Deca. Deca's volume in the second quarter was at around 6 million items. This volume was at around 9% lower than the same period of 2014.

The Wood division consolidated in the second quarter has a volume of 562,000 cubic meters. This volume was 13% lower than the same period of 2014, when the volume was 646,000 cubic meters. However, the EBITDA increased from R\$207 million in the second quarter 2014 to R\$210 million in the second quarter 2015.

The recurrent EBITDA (sic) [EBITDA margin] (05:09) were stable from 21.7% in the second quarter 2014 to 21.8% 2015, but it's important to mention that we increased the EBITDA margin from the first quarter 2015 when the EBITDA margin was 21.4%.

The net profit in this second quarter 2015 was R\$38.4 million. This amount was lower than the same period 2014 when the net profit was R\$58.6 million.

So turn to the page number four. And the idea here is to discuss the panel market in Brazil as a whole, not only Duratex, but the panel market as a whole. So the first picture has the MDF market, so the MDF market increased this first semester when you compare to the volume of the first semester 2014 net around 0.7%.

It's important to say here that MDF is more focused in class A and B and we sell through the retail segment. On the other hand, you have the MDP market that decreased 6.3%

year-over-year when you compare with the first semester 2015 against the first semester 2014. So here we have one segment that's more focused in class C and class D. Normally, we help the industry to produce the furniture to class C and class D and this segment depend a lot of the credit and the consumer confidence.

So right now, let's turn to the page number five and the idea is to discuss the operational highlights of the second quarter. So the volume (07:00) in the second quarter of 2015 on the wood division of Duratex was 562,000 cubic meters. This amount was at around 13% lower than the same period of 2014. However, it's important to reinforce that when you compare the volume of the first semester 2015 against the first semester 2014, the volumes were stable. So we have the same level of volume in this semester when compared to the same period of 2014.

In the picture below, you have the occupancy rate of second quarter 2015 in Duratex. The MDF had a level of occupancy of 62%, MDP had a level of occupancy of 48%, and finally, the hardboard had a level of occupancy of 69%. In the average, the level of occupancy of Duratex in the second quarter 2015 was 56%.

So moving to page number six and here we will discuss the net revenues, the recurrent EBITDA and the financial figures of Duratex of Wood Division in the second quarter. So the net revenue in the second quarter 2015 was R\$629 million, this amounts a little bit higher than the same period of 2014 when the net revenue was at around R\$620 million. When you compare the net revenue in the first semester 2015 against the first semester 2014, we increased the net revenue in more than 7%, basically due to a price increase that started in the second quarter 2015.

In the picture below, we have the EBITDA. So EBITDA in the Wood Division in the second quarter was R\$142.8 million. This amounts a little bit lower than the same period of 2014, when the EBITDA was R\$149 million.

As a highlight, we had three points to say here. The increase of 7% in price of MDP and MDF in the second quarter as I said before, the retail performance, keeping MDF sales stable and the last one but very important is growth of 18% in export volume. As I said before, it's part of our strategy to increase business that is coming from out of Brazil. So we've analyzed the Wood Division.

And now, let's move to page number seven and start to talk about Deca. So in this slide, you can see the building material industry, the ABRAMAT index. So this index decreased 7% when compared to the same period of 2014.

Moving to page number eight. And we'll discuss the operational highlights of Deca in the second quarter 2015. So the volume in this quarter was at around 6 million items. This volume was 9% lower than the same period of 2014 when the volume was 6.6 million items. The occupancy rate in the second quarter 2015 was 57% in the ceramic side in the sanitary ware and 69% in the metal fittings. It's important to say here that metal fittings is including the electronic shower division. The average of level of occupancy of Duratex in the second quarter was 65%.

So moving to page number nine. Here you have the financial figures of Deca. So the net income of that in the second quarter was R\$336 million, it was the same of the first quarter 2015 and very close to the same period of 2014, when the net income was R\$337.7 million.

So in the picture below, you have the EBITDA and the EBITDA margin. The good news is coming from the EBITDA. We increased the EBITDA of Deca in this quarter more than 50% when compared to the same period of 2014. The EBITDA in this quarter was R\$65.4 million (sic) [R\$67.4 million] (11:36) when the same period of 2014, the EBITDA was R\$58.3 million and when you compared to the first quarter 2015, we've increased EBITDA to more than 10%.

As I highlighted, we have the improvement in EBITDA margin from 18% to 20% when you compare to the previous quarter and when you compare to the average of 2014 when the EBITDA margin of Deca was close to 17.3%. This is due to, basically, two reasons. The first one is a better mix of products and the second one is the increased price that happened in the second quarter 2015.

So we've analyzed Deca, and right now, we are moving to page number 10 to discuss the CapEx for 2015. So as you know very well, our CapEx for 2015 would be amounting to CapEx of R\$400 million plus DuchaCorona acquisition. So far in the first semester 2015, our CapEx was R\$239 million which is totally in line with our forecast. The picture below has some financial figures and some details of DuchaCorona.

Turning to page number 11. And we are here to discuss the capacity evolution of Duratex over the last eight years. So in 2007, on the Wood Division, our total capacity was at around 2 million cubic meters, MDF, MDP and hardboard. Right now, after eight years, our total capacity is at around 4.1 million cubic meters, so it's more than double when compared with 2007.

We had the same movement in Deca division. 2007, our total capacity was at around 18,000 items, and 2015, our total capacity is at around 37,000 items, this is more than double. It's important to say here that we've analyzed important type of investments in 2013, when we increased the MDP capacity in Taquari, when we built our MDF line in Itapetininga and when we've analyzed the ceramic plant in Queimados.

So moving to page number 12, and right now, we'll discuss the corporate debt. So the total debt in the second quarter 2015 was R\$2.8 billion. The net debt was R\$1.8 billion, it was the same amount of the end of the first quarter 2015, is very close to the same period of 2014. Our corporate debt are stable. We are very comfortable with this kind of debt and the leverage of this debt.

In the picture below, we have the amortization schedule. So as you can see, in the second semester 2015, we have more than R\$700 million in terms of debt that will expire, and we have more than R\$900 million in cash to pay debt. It's important to say that we had enough money to pay the debt, but part of our strategy is to roll over this debt over the second semester 2015.

FINAL

In the picture beside, we have the composition of this debt. So 7% of this debt is in domestic currency. Basically, BNDES loans, rural loans and working capital (15:24). 28% of our debt is in foreign currency, basically for a Resolution 4131 and 100% of this debt are hedged. It's a part of our hedge policy to hedge our debt in (15:40).

And finally, turn to the page number 13 and the last one, the idea here is to give the main actions in 2015. The first one, the adjustment in the sanitary ware capacity. So as you know, we close out plant Jundiá in the end of last year and we shift the production to the modern plant in Queimados. So Queimados is a modern plant, multi-delivery (16:11) with low labor costs and tax incentive.

The point number two, and one very important one is regarding the Falconi Consultancy. As you know very well, we hired Falconi Consultancy in the end of 2014. We started to work together in the first quarter of 2015 and we are implementing the measures to reduce cost in Duratex for 2015 and 2016. The important measure that we are doing to face the price and to cut some inefficiencies.

Point number three is regarding our CapEx. As I said before, our CapEx is limited to the sustaining, except acquisition opportunities that added value to the shareholders.

Point number four is regarding our project to integrate Hydra and DuchaCorona. So Hydra is our electronic shower brand when we bought Thermosystem in 2012 and right now we are preparing the integration between Hydra brand and DuchaCorona after the acquisition of DuchaCorona in the beginning of July.

And the last one is regarding the joint venture that we did in the end of 2014 to plant forest in the Northeast region to support our panel operation in the future. This is the best decision and we've analyzed the possibility to build up plants over the next years.

So that's it. Thank you very much for your time, and right now, I'm available to answer the questions. Thank you.

Q&A

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. Our first question comes from Karel Luketic with Merrill Lynch. Mr. Luketic, your line is open.

Q - Karel Luketic {BIO 16467278 <GO>}

Good morning, everyone. Thank you for the question. My first question is regarding the Falconi initiatives you were mentioning. Is it possible at this point to identify the amount this initiative may bring to the company and on the same line here looking at cost, (18:40) cost in the second half and considering such benefits by Falconi, the clean energy prices and the U.S. dollar level that we're seeing it right now, but what sort of inflation can we

expect in the second half of this year versus the second half of last year? That's my first question.

And my second question looking specifically at Deca and volumes in the coming quarters, you were mentioning before you expect recovery sequentially on wood panels volumes, but looking specifically at Deca, what can we expect for the third quarter, what are you seeing so far in terms of dimension (19:14)? And that would be good. Thank you.

A - Flávio Marassi Donatelli

Karel, it's Flávio. Regarding Falconi Consultancy, we are expecting or we are in the middle of the plan of revising procedures, process and a lot of practices that we have here at Duratex. Of course, this consultancy is mainly focusing in cost reduction and to gaining efficiency, but it's very difficult for us to make forecast on a provision of how much we will reduce on costs during this period.

Our targets are very aggressive, but it's very difficult. At this moment in the company, we are certainly a lot of redundancies (20:14), as I told in the – during the Portuguese call, the market is very stable. So it's very difficult for us. When we think that we can reduce cost in something, a considerable time, we have decreased on the demand or an increase on the cost that you are not forecasting. So it's very difficult for us to define you of what is that number.

Regarding Deca, the Deca is suffering as all these civil construction sectors suffering. It's very difficult for us to again to forecast or to give some guidance about the markets. We are trying to be very well positioned in the market. We are reinforcing all our strategy in order to gain much share in this period, and we have no cost again. The margin of Deca in the second quarter came from a better mix and a stronger effort in order to reduce cost.

Q - Karel Luketic {BIO 16467278 <GO>}

That's great. Thank you.

Operator

Our next question comes from Lucas Ferreira with JPMorgan.

Q - Lucas Ferreira {BIO 16552031 <GO>}

Hi. Good morning, Flávio and Guilherme. I have a question regarding the working capital of the company. I noted that your inventories increased a little bit in the quarter. I'm wondering if you can revert that in the third quarter? And also we can see that there were a considerable increase in the accounts payable, if this is sustainable over time and if you could give us some color on the working capital in the second half of the year, that will be great.

A - Guilherme S. Souza e Silva {BIO 15325478 <GO>}

Just a second Lucas, please.

FINAL

A - Flávio Marassi Donatelli

Lucas, again, we all know (23:07) very good and we have to make sure that we have working capital. For us, the working capital increased in the second quarter for the plan, again, the certainty of the remainder (23:19) that may just include cost as we've had some plans to (23:28) that you can love to change it (23:30) but this can make us to increase certain inventories.

The second one is that we are expecting a better third quarter, so we are starting production in order to (23:51) the main increase.

Regarding accounts payables, we are - there is one thing. The terms that we are planning are the same. What you are facing now is some (24:09), mainly because the reduction of the sales of the MDP and the furniture to the retailer. Okay. It is reduction of certain - some clients had a lot of problems in terms of working capital. So we had to postpone the receivables with some clients. We do not foresee that you will have any loss in the state, but the delay (24:46) is increasing the economy.

Q - Lucas Ferreira {BIO 16552031 <GO>}

All right. Thank you.

Operator

Our next question comes from (24:55) with Citigroup.

Hi. Good morning, all. My first question regards the wood panel segment. I just wanted to understand the trends for the second half of the year. I know in the second quarter, we had very low operating margins but we've had better mix MDF, but looking at the inventories in the retail side, do you expect that maybe you should see a pickup in volumes on (25:24) maybe because we saw - because of the price increases that you announced in the second half, should we expect at least higher operating levels that have more normalized sales mix. This is my first question.

A - Flávio Marassi Donatelli

(25:48) again, all the view that you have of (25:53) is very small because that's good for us to predict to know what could happen. We believe that the inventory will be retained low (26:12) because the sales from the industry to them decreased a lot mainly during the month of June. So it's we believe that the industry has conditions to react if you have a demand during the third quarter. I don't think these low inventory (26:48) is that we think that normally the third quarter can - will be better, but again, all the consumer confidence under this interest rate are affecting the sales in the retail. I'm not sure if I answered all of your questions.

Q - Operator

Yeah. It's very clear, basically, the visibility is very low, but if inventories are low and if seasonality comes true, right, third quarter could be - we could see some better volumes,

right?

A - Flávio Marassi Donatelli

Yes. It's what we are expecting, okay. It's what we are expecting.

Q - Operator

The second question is regards CapEx. Are you guys expecting a CapEx of R\$400 million, right? Just wanted to understand if the acquisition of Corona of about R\$110 million, it's already embedded in this R\$400 million or it's some additional CapEx?

A - Flávio Marassi Donatelli

No. we are - the R\$400 million is all-in sustaining (28:09), okay. Part of R\$400 million, the R\$180 million is the foreign exchange impact, okay, to the (28:20) and we're increasing more than R\$116 million for the acquisition of Corona. So the total expense for this year will be R\$516 million.

Q - Operator

All right. Thank you.

Our next question comes from Gabrielle Benjamin with NSL (29:03).

Hi. Thank you for the time this morning. I'm wondering about the accounts payable case with participating members SCP. What that refers to and what we could expect for the year with that number?

A - Guilherme S. Souza e Silva {BIO 15325478 <GO>}

Do you repeat that please, Gabrielle (29:23)?

Q - Operator

Yeah. So you have an increase in accounts payables to participating members of SCPs, I guess they refer to the Florestal. If you could explain (29:35) that in terms of account payable increases as a result of that operation?

A - Flávio Marassi Donatelli

Okay. Gabrielle (29:41), thanks for your question. Yes, we had the attribute as (29:45) part of our synergy Florestal (29:50) who had some partners in certain areas. Normally, these contracts are six years, seven years contract of partnership. Now that you explore certain regions, certain investments in products. We did imagine (30:11) 2009, the beginning of 2010 and this is expected. The end of this (30:24) in February or March of next year, that's why we book from the long term to the short term liability.

We are rising them up if you can do another contract with them for the modest cycle of the Florestal. It's a very interesting operation, when you can finance it at a very low cost

the (30:57) of the Florestal.

Q - Operator

Can you explain just payment through the partners is dollars?

A - Flávio Marassi Donatelli

No, in reais.

Q - Operator

Okay. Thank you.

Our next question was sent through the webcast. It comes from (32:24) Capital Management.

Can you tell us the impact of Corona on revenues, EBITDA, in the net profit for the rest of 2015? Also detecting the very favorable in 2015, is that sustainable? What tax rate do you expect for the full year? Thank you very much.

A - Guilherme S. Souza e Silva {BIO 15325478 <GO>}

Okay. Regarding Corona, so we're assuming the DuchaCorona companies in this quarter, so we'll analyze the possibilities, but the idea is we don't have any kind of losses or profits and new EBITDA in this year of 2015. So regarding tax, Flávio will answer to that.

A - Flávio Marassi Donatelli

Yes, regarding tax, during the first semester, , (33:15) we recognized again (33:19) interests of (33:24), and due to the effect of our balance sheet. The dividend we'll maintain during the second half or probably at the end of the year, we got once again the dividend (33:46). It will be really that impact of (33:52). All the years we are using all the advantages we had with Ducha (34:02).

Operator

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

A - Guilherme S. Souza e Silva {BIO 15325478 <GO>}

So again, thank you very much everybody for following this conference call. And I and our team, IR team here in Duratex, we are available to answer the questions after this conference call. We may use our (34:27) conference call, okay. Thank you, again.

Operator

That does conclude Duratex's audio conference for today. Thank you very much for your participation. Have a good day and thank you for using Chorus Call.

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.

FINAL

Bloomberg Transcript