

Q4 2012 Earnings Call

Company Participants

- Alvaro Penteado de Castro, Executive Manager, IR

Other Participants

- Karel Luketic, 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'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. Please go ahead, sir.

Alvaro Penteado de Castro {BIO 5537843 <GO>}

Good morning. Thank you, so much for accompanying to us the conference call of the Fourth Quarter results.

I have here with me Flavio Donatelli, CFO; and (Cartagena Dohu), our Senior Analyst; along with me. We will go through the material, and after that, we'll take questions that you may have.

First of all, like to apologize for the change in the time of the conference. You'll know that today, Klabin, from the same sector as ours, is also disclosing results. So we decided to swap the times of the conferences between Portuguese and English, so not to conflict with Klabin, and make it possible for all of you to accompany both of the conferences; which we believe from companies are very good companies here in Brazil.

Anyway, starting the presentation on page 2, it is my pleasure to talk about the record results that Duratex posted, not only record but very solid, according to the (strict) rules. We posted record volumes.

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In the Wood division, there was an increase of 16%; making volume shipped reaching 2.6 million cubic meters. We will see that, along this presentation, that they have outperformed the market considerably. In Deca, although a more difficult scenario, we were able to increase volumes by 1% and revenues by 7%; outperforming the market as well.

Net revenues reached BRL3.4 billion, with an annual increase of 14%. Recurrent EBITDA totaled BRL1 billion, with a margin of almost 30%; consolidated margin. We posted recurrent return on equity of 11.4%, and 13.2% in the Fourth Quarter.

We announced on last Friday a dividend for the year of BRL(167) million, up 23% year on year; which represents BRL0.28 per share. And we also announced that the Board approved, or will submit to the General Assembly of April, a stock dividend worth 10%. So each 100 shares that a shareholder holds, by Friday, we will issue 10 new shares, if it passes on the General Assembly of April. There is still pending the (unitary) value per share. This will be presented during the General Assembly.

We continued our growth strategy, with acquisitions during the year; and in businesses outside Brazil, and in complementary businesses. Just to name, we acquired 37% stake in Tablemac, and also acquired two companies in Brazil, Mipel, last year; and in the beginning of this year, Thermosystem; as well, investments, too, in the ongoing operations both Deca and Wood divisions.

In the sustainability side, Duratex shares selected to take part of Dow Jones Sustainability World Index. And last Friday, we learned that our stock was also included in the Dow Jones Emerging Market Index.

Following to that, slide number 3, we have revenues here. You can see that, on a quarterly basis, consolidated revenues grew 2.8% to BRL936 million. I'd like to highlight that normally Fourth Quarter tends to be a little weaker than the Third Quarter, but not this year; the activities came very strong, very solidly. And in the beginning of this year, this is the same picture we have.

Gross margin, we reached 35%, 35.4%; and for the consolidated during the year, 34.9%, up from 34.1% in 2011.

Then we have the breakdown. We can see that Deca participation revenues is around 32%, one-third approximately of revenues; and the other two-thirds still with the Wood division.

Slide 4, we have EBITDA. We had some extraordinary events in the Fourth Quarter and Third Quarter 2012. So we took them off to have the recurrent EBITDA, BRL285 million during the quarter; and BRL1 billion for the year.

In the bottom, you have, on the footnote of this table, all these events there. So in the Third Quarter, we had the recuperation of PIS. PIS is a kind of a social charge, so we had

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the benefit of it in the numbers. And in the Fourth Quarter, there was a reversion of some tax contingencies worth BRL10 million; and in 2011 terms, extraordinary events also (led) to the sale of our assets, fixed assets.

Recurrent margins reached 30.5% in the Fourth Quarter of '12 and 29.6% in 2012 as a whole; very sound margin.

When we go to the net income, we finished the year -- finished the quarter, Fourth Quarter with almost BRL150 million and if we disconsider the extraordinary events, BRL131 million.

On the bottom, you have evolution of equity and return on equity. So we can see there was an evolution from 9.8% return on equity in '11 to 11.4%. Then we have a footnote here, we had some inefficiencies during the capex period, which is too long; just to name the new MDF line that probably will start up in July this year. We started investment in the plant itself two years ago. And if you consider the timberland asset six years ago, so if you disregard the negative impact of this investment on return on equity, it would have been 12.3%.

When we analyze on a quarterly basis, we can see that there was an evolution from 8.7% return on equity Fourth Quarter '11 to 12.5% Third Quarter '12, and 13.2% Fourth Quarter '12. So very sound results that we posted this year.

Following to that, slide number 5, we have the picture of volume shift in the Wood division for both MDF and MDP. We can see that the MDF market continued to post very strong growth. When you analyze year on year '12 against '11, there was an increase of 15% of volume shift. And this includes the numbers, of course, of Duratex. And in MDP 6.4%, a little more softer, but the occupancy rate here was at full, so there was not much room to grow volumes here.

If we add both, we have a total performance for the market of 6.7 million cubic meters, a 10.8% year-on-year growth. If we take off the Duratex volume from this performance, which we have in the last page, you will see that without Duratex, the industry would have grown 7.5% instead of 10.8%. So we contributed a great deal for this good performance that you see with this year.

Slide number 6, you have volume shifts for Duratex, (in the year long); again, a very sound performance, 16% volume growth year on year when compared to the 7% of the rest of the industry.

On a quarterly basis, year on year, 26% growth and stability year on year; just to remind you, Fourth Quarter normally there's a seasonality in the performance in the volume shipped. So capacities above -- or close to full capacity, MDF 99% occupancy rate, MDP 94% and hardboard 99%. So we believe that the investment carried on; (meaning) the new MDF line should be completed and start running in Itapetininga will contribute decidedly for this sustainability of results looking forward.

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And besides that, we have an ongoing investment also in the Taquari plant for MDP that will be due by end of July -- or end of June, I'm sorry, beginning of July. This investment will contribute for an extra 230,000 cubic meters of extra capacity of MDP that should be very welcome in the sort of scenario that we see ahead of us.

Following page, net revenues for the Wood division; just one point here, you guys probably realize that we changed our logo type. So whenever we are talking about the Wood division, you will see Duratex in small letters, with the rhino going after the brand. When we're talking about consolidated data, we're talking about capital letters and the rhino horn over the brand name.

So in this case, slide number 7, we're talking about the Wood division revenues and gross margin. We can see there was an increase of 18% in revenues and margins growing by almost 200 basis points year on year. And when we analyze on a quarterly basis, we can see revenues increasing by almost 30% and 3% quarter on quarter. And margins, gross margin reaching 35%, almost 200 basis points above what we posted during the Third Quarter.

EBITDA, of course, it shows the same sort of strength in the numbers. 2012 against '11, there was an increase of almost 40% on EBITDA. Margins going from 29% to 33%, 400 basis points improvement. This comes along with gains of scale and a better product base and mix, basically. When we analyze on a quarterly basis, we can see the Fourth Quarter '12 against '11 shows an almost 75% increase, and this is recurrent EBITDA.

Following to that, the same analysis for Deca, so we are on slide number 8, here is the Abramet Index. Just to remind you, the Abramet Index measures the revenues of the building material industry. So this is growth year on year on financial terms, revenues domestic market.

So we can see that in 2011, the building industry show -- or posted a 3.2% revenue growth. And in 2012 1.4%, being much closer to what should be the GDP for Brazil.

If we flip the page, we can see that in terms of volume, Deca posted 1% growth year on year; and when we analyze on a quarterly basis, pretty much stable and a decrease of 4.5% when compared to the previous quarter.

But still with very high utilization rates; in metals 96%; sanitary ware, ceramics, 91%.

Following to that, we have revenues for Deca showing that we outgrew the market. We posted a 7.7% increase in revenues as opposed to 1.4% that the Abramet Index shows. On a quarterly basis, the performance was a little better; year on year an almost 9% increase and 2% increase quarter on quarter.

EBITDA in Deca increased 1.4% to BRL272 million. EBITDA margin suffered a little bit here, reducing it from 24.6% to 23.2%. Here, more specifically in the Fourth Quarter 2012, we

started to consolidate Mipel operations in Deca. And just to remind you, Mipel has a lower margin than Duratex, so contributed a little bit drain margin here.

And we also had to recognize the extended warranty effect -- financial effect on the operating numbers of Deca, which represented BRL5 million for the year. So that was one-time event, but still bringing down the operating performance of Deca a little bit.

Just to remind you, from the First Quarter '13 onwards we will start consolidated Thermosystem as well. And Thermosystem also has a lower margin than Deca as a whole. So this sort of margin probably should be seen in the coming quarters.

Following to that, slide number 11 brings an overview of the investments carried on in the Company. First, in the Wood division we have a new MDF line in Itapetininga, with an effective capacity of 520,000 cubic meters, which startup is scheduled for the beginning of the second half-year 2013; also, the completion of the MDP investment that I commented a little while ago, with a capacity increase of 230,000 cubic meters in the Taquari facility, and the acquisition of a 37% stake in Tablemac. And just to remind you, this operation is being recognized under the equity methodology in the Company. We are not consolidating Tablemac yet.

Following to that, in Deca we have here the acquisition of Mipel, again; consolidated already in the Fourth Quarter 2012. Also, investments to grow the capacity organically in Metal Fittings by 1.2 million items a year; making the capacity increase from 17 million items a year to 18.2 million items a year.

And we should also be an inaugurate, this year, probably during the Second Quarter, the ceramics unit Queimados, which should add 2.4 million items a year to the current capacity of Ceramics.

All of that, of course, along with the acquisition of Thermosystem that took place in the beginning of January 2013.

Below we have a graph, a table, showing the investments during the last years. So the Company issue -- or posted investments of BRL832 million last year. And for 2013 we expect investments around BRL660 million, without considering a possible acquisition.

Following to that, on slide 12, we have a chart showing the historical evolution of capacity for both Wood division and Deca division. We can see that this year we will end up the year with 40% more capacity in MDF and almost 7% more capacity in MDP.

And there is a new or pending investment to be more detailed of a new either MDP or MDF new line. We will make the announcement of the ForEx capital for this new line in due time.

In the bottom we have investments in Deca. Again, we finished last year with 18.2 million items a year in Metal Fillings, 9.8 million in Ceramics. And this year a further 9% increase in

Metals, with Mipel and the addition of a possible second shift in the Deca production facility. And in Ceramics, with the entrance of Queimados, this represents the bulk of the 28% increase in capacity that we see here from '12 to '13.

And in the bottom we have Thermosystem with 1.5 million items a year of electric showers and solar heaters that are included in our portfolio from now on.

Flipping the page to slide 13, we see that the Company ended the year with a total debt of BRL2.4 billion. Although a little higher than the total debt by the end of September 2012, when we finished the quarter with BRL2.2 billion, when we analyze the leverage against equity, there was a (reducement) from 35% to 34%. And even net debt to EBITDA, the ratio was reduced from 1.5 times to 1.3 times.

So the financial condition of the Company is still very healthy, very positive, to keep analyzing M&A possibilities and exploring the best investment possibilities to grow further the businesses and aggregate value through shareholders.

The amortization schedule is really pretty much comfortable. We had on cash BRL1 billion by the end of the year, and this year we have maturities of BRL680 million. So if we decide to pay all our debt, we would have cash to do that, so it is not a relevant issue to us with regard to the amortization schedule of payment.

The origin of the debt; 87% was taken in domestic currency and whatever was taken in foreign currency was hedged. So our debt is mostly denominated in reais and in CDI or TJLP; mostly.

Following to that, on slide 14, there is a slide about sustainability, and, again, the inclusion of our shares in the Dow Jones Sustainability Index. That was a major event for us in 2012. And now demands us a great deal of compromise to keep ourselves included in such index. We believe that, for the corporate image of the Company, this is fantastic and we'll do everything on our hands to keep ourselves in such index.

And remind you that last Friday we were included in a second index from Dow Jones, the Emerging Markets, along with another 15 Brazilian companies; two more from the (Group) itself and with Banco Itau along with Duratex.

Best grade in the sector in five criteria. That's outstand itself in antitrust, policy, crisis and risk management, international standards production, transportation and logistics and stakeholder engagement. So we are highlighting all of these criteria here.

Following to that, on slide 15, we have the stock performance. We were the fourth best performer last year. Unfortunately, we lost some room during the beginning of this year, but after these results we believe that the market will receive -- and we'll price it accordingly. All the materials, the market comments have been very positive so far and should reflect on the (Stock Exchange), hopefully.

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With that, I conclude my presentation and now I put myself and my colleagues here available for the questions that you may have. Thank you.

Questions And Answers

Operator

(Operator Instructions) Thiago Lofiego, Bank of America.

Q - Karel Luketic {BIO 16467278 <GO>}

This is actually Karel. I have two questions regarding the wood panel segment here. We saw in the Fourth Quarter, despite the seasonality, strong volumes. We were wondering if with what you have seen already in the quarter, do you think there could have been some IPI acceleration of sales in the Fourth Quarter, which could lead to weaker volumes in the First Quarter? What I mean is basically if you have seen any deceleration of volumes in the First Quarter? So that's the first question.

And the second question, if you could provide an update on prices. We saw you were able to implement price increases in the wood panel business in the Fourth Quarter. Is there anything else coming in the First Quarter, or have you been implementing something here; just wanted a quick update on that if possible.

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

Okay, Thiago, thank you for your question. Yes. The performance during the Fourth Quarter came strong. It is -- the performance of the Wood division during the whole year of 2012 surprised us. We started the year believing or expecting a volume growth of 6% and in the end, it came much stronger than that. And the performance was very solid, very consistent during the whole year; so much consistent that we decided to push some price increases even during the beginning of this year.

Normally, it is not very desirable, because normally, you have a weaker period. So normally, you might increase prices more down the road, more towards the Second Quarter. But the performance is -- or the market is performing so well that we've been able to push some price increases, even during the First Quarter this year, in the amount of 6% in Wood and 5% in Deca. So our reading is that the market is very okay. On our -- go ahead.

Q - Karel Luketic {BIO 16467278 <GO>}

That's additional to what you had implemented in both Deca and Wood in the Fourth Quarter? And for Wood, that's for both MDP and MDF?

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

In Deca, no, Deca is the same price increase, but in the Wood division, yes, on top of what we increased in October last year, we increased 6% this year.

Q - Karel Luketic {BIO 16467278 <GO>}

For MDF and MDP?

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

So it was around 6% on October and another 6% now.

On our budget, we are working with nominal price increases the situation this year. So so far, that's it. Probably there is not further price increases during this year unless, of course, demand keeps surprising us.

Q - Karel Luketic {BIO 16467278 <GO>}

Okay. Thank you.

Operator

(Operator Instructions) Thiago Lofiego, Bank of America.

Q - Karel Luketic {BIO 16467278 <GO>}

Hi, Alvaro, sorry, just one more follow-up there. The price increase of 6% for wood panels is both for MDP and MDF?

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

Yes.

Q - Karel Luketic {BIO 16467278 <GO>}

: Okay, perfect. And since, well, I didn't see any more questions there, so going into the Deca business, the price increase is already announced, so not additional, right?

Then you mentioned the margins were impacted by Mipel's integration, you also mentioned there on the middle of the call, that you expect compressed margin within this 20% levels for the next quarters. How long do you think this could take to normalize? Or do you see this as a new normalized level for Duratex, this 20% for Deca, right?

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

I think this tends to be a floor for now, Thiago. You have to remember that we are not only consolidating new businesses with lower margins, but also, we are about to commission a new plant in the Second Quarter this year that -- you know that in the beginning of the ramp up, there's some inefficiencies. You have to -- you have people, you have energy contracted and, normally, in the beginning, you don't have the correspondent output volume to compensate this initial momentum.

So my guess is that during this year, the margins will be -- probably will have a floor of 20% or around what we posted in the Fourth Quarter and move from there. Okay, of

course, that if we're able to implement all the changes that we desire to do in both Thermosystem and Mipel, we'll start turning around and improving the margin.

Just to name one of these themes, in Mipel, we are adding this year already a second shift, with the addition of the shift, we should start diluting the fixed costs and improving a little bit the margins in that operation.

For Thermosystem, that operation is running very close to full capacity. Some investment is needed, so as to us to improve production and start implementing our strategy to use Deca distribution network to improve the market share of this business and the shower business in Brazil. We know that to date this unit is too much concentrated in the south part of Brazil and we intend to make the showers available in other regions. But in the beginning, we need to invest a little bit to make it happen.

So it is a move; it's an escalation. And we believe that margin should improve during the course of implementation of this strategy.

Q - Karel Luketic {BIO 16467278 <GO>}

Okay. That's great. Thank you.

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 to proceed with his closing statements. Please go ahead, sir.

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

Thank you, so much. If you still have any doubts, please do not hesitate to get in contact -- get in touch with us; myself, (Cartagena or Pradu), we are -- will be more happy to assist you.

Thank you, so much and have a great day.

Operator

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

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