

Q2 2018 Earnings Call

Company Participants

- Felipe Saraiva, Unknown
- Guilherme Setubal Souza E Silva, Executive Manager of IR

Other Participants

- Thiago K. Lofiego, Research Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to the audio conference call of Duratex. Thank you for standing by. (Operator Instructions) As a reminder, this conference is being recorded.

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

Guilherme Setubal Souza E Silva {BIO 20114864 <GO>}

Good morning, everyone. And thank you for joining us in this conference call. Felipe Saraiva, our IR Coordinator, is standing beside me. We will present the results for the quarter, the Second Quarter. And later, we'll be available for the Q&A section. I'd like to invite you to turn to Page #2 where we present the financial figures.

So on the Slide #2, let's start. Our overall analysis of the company's performance for the quarter is quite positive. As you may be tracking, the economy's recovery is slower than we expected early in the year. In addition, we saw the truck drivers' strike in May, which affected activities in the country as a whole. We managed to partially offset the scenario and even in a challenging environment, we have made progress in almost all operations.

The net revenue in the quarter was BRL 1.2 billion, which represents a 27% growth compared to the Second Quarter last year. The highlight of this performance was the higher volumes sold in the Wood and Deca Divisions. We can go over the details further on. Moreover, the incorporation of Ceusa's results, which appeared in the last quarter of last year. And the performance outside Brazil, both through exports and in our operation in Colombia, also contributed to this improvement. The recurrent EBITDA was BRL 220 million, an increase of 23.3% over the same period last year. We have also seen an increase in net profit, which has amounted to BRL 27 million. I would like to remind you that for the recurrent results, both in EBITDA and net profit, we have not included the

transaction with Suzano. This improvement reinforces the organization's commitment to Duratex Management System and our target to return to more attractive levels of returns.

Let's turn now to Page #3 where we talk about the debt and the cash flow. So on Slide #3. We have been sharing with you for a few quarters our goal of reducing the financial pressure on the organization. The initiatives that we have condoned in our operations and the sale of assets have had a positive effect on Duratex's debt, with the continued strength of deleveraging. We ended the quarter with a net debt of BRL 2.1 billion, lower than the First Quarter of this year.

As you can see on the free cash flow chart, we're going to raise more cash in the semester than the last year, considering that the disbursement that we have included with Ceusa. Duratex Management System was a key to this improvement, in addition to the sales of the assets that have accelerated this process. The transaction with Suzano for the sales of forestry assets accelerated Duratex's deleveraging process, preparing the company for the further steps in our strategic plan. We have already received partial payments of the half of the first tranche of this transaction. The first tranche was BRL 300 million, we've received BRL 150 million.

On the other hand, we have paid BRL 81 million tax related to the deal. We paid tax related to all transactions, BRL 300 million. But received so far only half of that. And the other part we'll receive in December 2018. The second tranche of the operation, it is still pending closure. But there is still revenue to be collected related to this year.

Let's turn to Page #4 where we'll discuss the details of working capital and CapEx in the Second Quarter. Slide #4. We have seen an improvement in the company's cash conversion cycle in this quarter, with a reduction of 10 days compared to last year. The positive highlights in days payable outstanding and the days of inventory outstanding which show a consistent improvement in the period. The average term for the trade receivables shows a slight deterioration, basically due to the concentration of sales at the end of the quarter as a result of the truck drivers' strike.

Regarding CapEx, we invested BRL 115 million in the quarter. Of this amount, BRL 68 million was invested in biological assets formation and BRL 47 million in advancing on projects. As we discussed previously, the focus of our investments remains on the sustaining operations. We've reinforced the organization's commitment to the long-term results despite efforts to minimize the pressure on the cash investments. I'll give further information later in this presentation. But we have approved an investment plan to expand our operations in Ceramic Tiles.

Now please turn to Page #5. I will hand you over now to Felipe, that he will discuss the 3 business units. Felipe, go ahead.

Felipe Saraiva

Thank you, Guilherme. Good morning, everyone. Thank you for joining us on this earnings call.

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So I'm starting my presentation on Page five regarding the figures for the Wood Division. So the main highlights for the Wood Division during this quarter was the increase in volumes. We have a good sales performance during the quarter, both in the local market and also in the foreign market. We increased our market share here in Brazil. The volume shipped during the quarter was 614,000 cubic meters. This result, I think, contrasts with the last year. I think we have an important gain of market share if you compare the last 12 months.

Net revenues for the quarter were BRL 747 million, an increase of 32% over last year. I just have a disclaimer here. Our neighboring folks that the -- part of the deal with Suzano regarding the sale of biological assets. It's incorporated in the net revenues. Our utilization rate during the quarter was 66%, which represents growth from the 60% level that we were operating in the previous quarter. With the operations being in Itapetininga running, (inaudible), we've already noticed a positive impact in reducing the idle capacity in our operations for our wood panels.

Duratex Colombia, our operations in Colombia also presented good results. The local operations in Colombia improved, as they were also benefited by the FX gains. So if the Colombia peso has appreciated against the BRL. Recurring EBITDA for the quarter was BRL 163 million. It's worth mentioning here that the recurring EBITDA does not incorporate -- disregards the sale of land and forest to Suzano. In addition to the better scenario we have seen in wood panels, we have also increased the sale of timber to third parties. So we have sold something around BRL 20 million more than we were used to sell from the previous (inaudible).

I'll turn now to Page six where we'll highlight the main initiatives of the Wood Division for the second half of this year. So according to this, the value proposition of Duratex of offering solutions for better living, we are working on improving wood panels product mix. We are moving forward to a more value-added portfolio to improve the returns of our operations. In addition, the outlook that we have for wood panels for the second half of this year is positive. We expect growth for wood panels demand in the second half. Therefore, we are prepared to capture this potential improvement in demand with (inaudible) running on a flexible model.

As we speak, we are also implementing some price adjustment for a few lines. So we are implementing 4% to 7% of price hikes, with the main focus on the particle board lines. This is not going to be an increase across the board of our portfolio. But it's just some specific adjustments that we have been doing right now.

We are also -- I'd also like to highlight here a greater maturity that we have achieved in our S&OP sales and operations planning process, which we have reviewed last year and we have been sharing with you guys so far. The more efficient management of productivity chain should bring us some benefits, especially in the inventory management and also in productivity for the second half of this year.

Lastly, in the meantime, we are redistributing the product mix among the mills that we have. So we have 5 different mills in our footprint. We are trying to get the most from the

setup of each of those lines.

With these initiatives that I presented to you guys right now I'd like to end here the part of the Wood division and turn to Page 7, where I will explain the Deca figures. So the capacity to increase sales and also to generate revenues is one of the main attributes of any business. And Deca has shown, once again, the potential, especially the marketing, the great potential that this business has. We have noted during the quarter, our growth in sales and also in revenue despite the challenging that is still -- the scenario that is still challenged for the civil construction in Brazil. So our volumes were 6.8 million items, with the net revenue of BRL 374 million. This increase in net revenues represents a growth of 9% compared to the same period last year. We are still operating with a lot of idle capacity, especially for ceramic sanitary ware. In addition to this idle capacity, we have been seeing in the market some pressure, some cost pressures in raw materials and some (inaudible) among our production, especially during the Second Quarter, which I will explain later. We are addressing to fix those issues. Our EBITDA during the quarter was BRL 47 million, with a 12.6% EBITDA margin. We have an ambitious plan to reverse this cycle and I would like to explain it to you guys on Page 8.

So this plan contemplates a holistic approach to Deca business looking for some commercial initiatives, industrial manufacturing initiatives, clean initiatives and in addition, some people initiatives to try to reverse the short-term scenario.

We announced in July a second price increase in Deca Division. So we are increasing 4.5% the prices for our metals in Deca Division. This increase -- the idea of this increase is to offset the inflation that have been seen in raw materials.

On the other hand, we have increased price and investments at the point of sale. The idea here is to create some actions to improve the sellout of our products, in the retail especially. And to stimulate a better demand throughout the balance sheet.

In the meantime, we are drafting a lot of initiatives to increase productivity and to cut costs in our operations, supported by the Duratex Management System, our (inaudible) to improve the performance of Deca (inaudible).

Finally, we are evaluating our general expenses, especially the fixed expense that Deca has. We have a firm commitment to reduce the fixed costs of this operation. At the manufacturing areas, we have finished in June a restructuring of the hierarchy to try to be more agile and more lean in the decision-making process.

Lastly, I believe Deca has the potential to deliver consistent performance during the second half of this year. As we saw on the previous page, sales have not been some -- a major offender so we do believe that with execution capacity to implement these initiatives and to implement the short-term plan, we can have a second half of results better than the first one.

I'd like now to turn to Page nine where I'll present the results for our Ceusa, for Ceramic Tiles business. Now all of our operations, among all of our operations, Ceusa has been

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the one that's struggled the most with the truck drivers' strike. Since it's running with almost full capacity, we have lost some sales. So although we lost sales, we have here partially offset of this process. We presented a volume achievement of 1.2 million square meters, which reflects a net revenue of BRL 46 million. The capacity utilization remains at an attractive level. We're talking about 94% of capacity utilization rate. The EBITDA of the division was BRL 10 million, slightly lower than the one that I had presented in the First Quarter of this year. This drop was due to the disruption to the transportation sector and it was partially offset by a better mix of products. I emphasize that the operation of Ceramic Tiles continue to be above our expectations and above what we have initially planned, reinforcing the quality of the investment -- the high quality of the investment that we have done last year. We are expanding these operations and would like to detail these on Page 10.

So let's move. We have approved investment plan to expand capacity in Ceramic Tiles. With this expansion, we are looking for increasing Ceusa's market share and its contribution to Duratex's consolidated results. We shall see an improvement in margins and returns as a result of this expansion. It will be BRL 94 million between this year, '18. And also '19, to modernize the existing lines. And also to build a new one.

Since we knew that we'll receive the new line, already had all of the infrastructure to do so. The investment was sharply reduced. And it is big, the payback and the return of this investment. This investment will expand Duratex's production capacity by 83% in Ceramic Tiles going from the current level of 6 million square meters per year to 11 million square meters per year after the conclusion of this project.

It's with great satisfaction that we're growing in certain attractive business, which represents the new Duratex -- the Duratex that we are trying to build.

I'd like now to hand over to Guilherme for the final statements in Page 11.

Guilherme Setubal Souza E Silva {BIO 20114864 <GO>}

Thank you, Felipe. And so let's turn to Page 11 and the last page of the presentation with an (inaudible) to say this on the path to higher returns. So we split it into 4 topics that we'd like to explain to you.

One of the main topics during the conversation with investors is about Duratex's potential to improve returns. Our strategy is based on the items that we present in these slides.

Number one, excellence in management will be key to this strategy. We are stressing the Duratex Management System, which is already fully disseminated to our organization. And is our main tool for managing revenues, costs, productivity and investments.

Number two, a topic that we talk a lot of times regarding the culture transformation. It is always worth mentioning the culture transformation of the company. It is already in the third year. This new approach to our business has been a key to all the change that we are implementing. I would like to take this opportunity to welcome Marcelo Izzo, Deca's new

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Vice President, who joined the team in early May. This new culture will be fundamental to changing the level of returns that we can deliver.

Pillar number three, asset allocation. Regarding capital allocation, we have done detailed review in our asset base, which culminated in the material transaction in the first half of the year. The first one, an operation with Eucatex. We have sold equipment dedicated to the production of hardboard. This transaction is under review by CADE and as soon as we have the final decision, we'll communicate the time line when they enter the market.

Subsequently, we sold an important amount of land and forest to Suzano, a transaction that finishes in the beginning of July with the exercise of the call option.

And the last one, the growth agenda. In addition. But looking at the growth, we have begun a partnership with the Austrian group, Lenzing, to develop a DWP project, dissolving wood pulp.

We are dedicating ourselves to the fulfillment of the preset conditions for the effective close of this deal that will happen in the half of next year. As I briefly explained, we are increasing our capacity in Ceramic Tiles, an extremely attractive business from the point of view of return.

And last but not least, we remain committed to assessing opportunities for increased revenue through the avenues of growth that we have shared with you before. The strategy to expand returns also involves growth, which will happen in the business with more attractive returns.

I'd like to finish here in the presentation and myself and Felipe, we are available for the Q&A session. Thank you very much.

Questions And Answers

Operator

(Operator Instructions) The first question comes from Thiago Lofiego with Bradesco BBI.

Q - Thiago K. Lofiego {BIO 16359318 <GO>}

Just a couple of follow-up questions from the other call. First question, on the price increase initiatives, could you please give us some additional color on these initiatives? Maybe the magnitude or the range of potential magnitude for these hikes, both for wood panels and also for Deca? And the second question is related to CapEx. Could you please confirm what's the expected CapEx number for 2018 and also for 2019?

A - Guilherme Setubal Souza E Silva {BIO 20114864 <GO>}

Okay. So Thiago, regarding prices. So in Deca Division, we announced a price hike in metal fittings and the price was 4.5% in the average of the portfolio. On the wood panels, as we

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mentioned before, I mean, the range is between 4% to 7%, more focused on the MDP product, the particle board, right. But not for the old portfolio. Part of the portfolio and part of the client. So the majority of the clients that buy MDP will have this new price. But it's not in the old portfolio, okay? So the second point, regarding the CapEx. So our forecast for this year is around BRL 450 million, right? So we are a little bit below this number if you double the CapEx of the first semester. But including Deca, the expansion in Ceusa, next year, probably will be a little bit higher than that, maybe more close to BRL 480 million or BRL 500 million, including the expansion in Ceusa. If you'd like to add some comments here, please?

A - Felipe Saraiva

Yes. I mean, we should have some saving in CapEx regarding the initial forecast for this year that was BRL 465 million, BRL 465 million. We should have some saving since we are running the first semester below this level. But we also have the addition of Ceusa's expansion. It's BRL 94 million. Disbursement of this CapEx should be half and half, half this year and the other half next year. This is the main change on the initial (inaudible) that we have for CapEx.

Q - Thiago K. Lofiego {BIO 16359318 <GO>}

Okay. And just another question, if I may, on the cost dynamics of Deca. You guys have been facing some pressures related to metallic inputs and the currency depreciation. And you mentioned there's some initiatives to improve the cost performance of Deca. Could you elaborate a little bit more on what can be done and what's already -- what is already being done and the potential impact for the coming quarters? Or this is something that we are not going to see any kind of positive benefits in the third or Fourth Quarter, maybe just for next year?

A - Felipe Saraiva

Okay. So regarding the hike in the cost of commodities and also the FX situation, we are adjusting, again, the price -- we are implementing a price hike for metals to offset these impacts. And regarding the productivity, especially for ceramic sanitary ware, there's a lot of initiatives combined. We think the Duratex Management System should try to reduce. The idea is to reduce the cost base during this year so we should see a better cost performance of benefit through the second half of this year. We are expecting some impacts already for the Third Quarter. Those are our main initiatives regarding productivity in the ceramic sanitary ware facility. And also, we have an evaluation of the fixed expense of Deca. So the idea is to reduce the fixed costs of the division as a whole. Those impacts, you might see some impacts of these initiatives already in the second half of the year starting in the Third Quarter.

Operator

(Operator Instructions) This concludes today's question-and-answer session. I would like to invite Mr. Guilherme Silva to proceed with his closing statements. Please go ahead, sir.

A - Guilherme Setubal Souza E Silva {BIO 20114864 <GO>}

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So thank you, everyone, to join us in this conference call. Myself and Felipe, we are available to answer any questions that you may have, okay? Thank you very much. Have a nice 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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