

Q3 2016 Earnings Call

Company Participants

- Guilherme Setubal Souza e Silva, Executive Manager-Investor Relations

Other Participants

- Juan G. Tavaréz, Analyst
- Steven Rivoir, Analyst

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. 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, Investor Relations Manager. Please go ahead, sir.

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

Good morning. Thanks for following Duratex's third quarter results. My name is Guilherme Silva. I am the IR Manager of the company. So, the idea here is to discuss the financial figures of this third quarter 2016 and the strategy of Duratex for the next years.

So, first of all, please turn to page number 2. And here, we have the net revenue breakdown, right? So, as you can see, the Wood Division represents around 66% of the revenues, and Deca Division represents at around 34% of the revenues. We are the largest metal producers of bathroom fittings and wood panels in Latin America.

You see below our competitive advantage, high-quality facility and forestry, our vertical integration, forestry productivity. We are self-sufficient with low cost in the wood. It's very important to say here that the wood represent the main cost to produce panels in Brazil. Our geographical location, top-of-mind brands in both divisions, Deca and Duratex, and we have a very strong corporate governance.

On next page, page number 3, we have our shareholder structure and corporate governance. As you know, we have a block control with 60% of the shares. Basically, we have two main shareholders: Itaúsa with 40% of the shares and Ligna with 20% of the

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shares. The rest, 40%, are free float. Basically, 70% of our free float are foreign investors, and the rest are local investors.

Below, you see our board composition. We have nine board members, okay, four members from Itaúsa, two members from Ligna, and we have three really independent members. It's important to say here that members do not take up executive position in our company.

Beside, we have our committees. We have five committees to support the business. First one, the Personnel, Governance and Nomination. We have the Sustainability Committee. We have Audit and Risk Management. We have Disclosure and Negotiation. And finally, we have a committee to analyze transactions with related parties. For example, this committee is composed by only the independent members, and we analyze the transactions between, for example, Itaú Bank and Duratex.

So, please turn to next page, page number 4. And here, we have the history of the company. Duratex is one company with 65 years. We can see the time line. Our acquisitions, mergers, and new business over the last years, right? So, if you'd like to discuss later, we can discuss, okay?

On the next page, page number 5, we have the Wood Division geographic location. As you know, we have three plants in São Paulo: Botucatu, Agudos and Itapetininga. As you know, last December, we decided to shut down temporarily the plant of Itapetininga. In addition to that, we will have one plant in the South, in Taquari, and one plant more close to the North in Uberaba, Minas Gerais. Besides, we have our business in Colombia, Tablemac, right? In Colombia, we have three plants: two plants of MDP and one small plant of MDF.

On the next page, page number 6, we have our main products and channel distribution in the Wood Division. The main products are MDP, MDF, flooring, and hardboard. The main distribution channels are furniture industry that represents at around 50% of the sales; retailers, that represent around 30% of the sales. Retailers are in Brazil are some shops like Leo Madeiras and (05:20). And the rest, 20% of the sales are for the home builders and exports.

On the next page, page number 7. Here, we have the Deca Division geographic location. We have two plants of metals in São Paulo State, basically in São Paulo State, Jundiaí and Jacareí. Regarding sanitary wares, we have five plants spread around Brazil. Why? Because the freight cost to ship, the transportation of ceramic is very expensive. That's why we need to have one plant in each region. We have two plants in the Northeast. We have one plant in the South. We have one plant in São Paulo and one plant in Queimados, Rio de Janeiro.

In addition, as you know, we have two plants of our new business, electronic shower, one plant in the Northeast, in Aracaju plant that we bought from Corona; and one plant in the South Tubarão, Santa Catarina, the business that we bought from Thermosystem.

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Turn to next page, page number 8, and here we have our main products and main distribution channels in Deca Division. The main products are sanitary ware, metal fittings, accessories, and electronic showers. The main distribution channels are home center that represent around 50% of the sales, retailers with 25% of the sales, home builders with 22% of the sales, and the rest 3% are exports.

So, please turn to page number 9, and here we have our sustainability strategy. So, we review our sustainability platform this year, right, and this new platform, we have four pillars: people, process, goods and services, and new business model. So, you can see this new platform in our website, and if you'd like to discuss more about that, we can schedule a (07:32) conference call.

And right now on the next page, page number 10, the idea here is to discuss our strategic projects, right? So, here is a big picture with all of our project, right, so Integra, OBZ and SGD, Logistic and Enter. So, we will discuss each one on the next few page.

So, on the next page, page number 11, here we'll discuss SGD and OBZ, the two projects that we start in 2014 and 2015 with FALCONI Consulting, right? So, SGD, as you know very well, is more focused in variable cost. The idea is cutting variable costs and increasing revenues. How we can do that? Efficiency in consumption and purchasing price, increasing active customers with price and mix management.

And the other one is OBZ, more focused in fixed cost. The idea is cutting fixed costs and expenses. How we can do that? Redefine head count, matrix management of fixed expenses. These two programs, as you can see above, is linked with Duratex company, okay?

In the next slide, slide number 12, we can see the Integra, Logistic and Enter projects. So, the Integra is a project very focused on the inventory, right? So, what we are doing? Modernize our manufacturing record, management of availability of manufacturing units, and inventory management of all products. So, this program, this project is very focused on the inventory side.

The second one, Logistic project, very focused to reduce freight cost, right? So, the idea is to cut freight cost and improve the service level. And the last one is Enter. Enter is very focused on sales. So, we can see Enter is linked to the customer side, right, so as Integra is linked between the supplier and Duratex. Regarding Enter, the idea is the sales model restructuring, B2B and B2C. And the idea is through performance management of the sales staff, right? So, this product will start next year, right, and very focused on the sales side.

Please turn to next page, page number 13. And here, we can see our cost management and efficiency, right? So, in this slide, we are comparing the cost in the third quarter 2013, the best year of the company, against the third quarter 2016. During this period, the inflation was 25%, okay? During this three-year period, the inflation was 25%. So, as you can see, our SG&A increased only 5.5%. Per division, on the Wood Division, our fixed manufacturing cost increased only 6%, and our fixed commercial sales cost decreased

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10% during this period. On the other business, Deca Division, the fixed manufacturing cost increased 3.5%, and the fixed commercial cost increased only 3.1%. So, as you can see, our costs have increased significantly less than inflation during this period. This shows our effort to reduce our variable and fixed costs.

So, please, turn to next page, page number 14, right, and here we have, in my view, our main project, the cultural project, okay? So, this project has a strong engagement from the board and the senior management of the company, right? So, this is very important to have success in this project, right?

And the idea, we have four pillars in this project. people; meritocracy; the company need to be open to have dialogues with all employees of the company; and finally, we need to speed fast (12:09) the demands from our stakeholders, suppliers, customers, shareholders and employees, right? So, this project started in the beginning of this year. It probably will take more, two or three years.

So, please turn to next page, page number 16. And the idea here is to discuss the financial figures of this third quarter 2016. So, let's start with the highlights of this quarter. EBITDA margins, an improvement of the EBITDA margin in both divisions, Deca Division and Wood Division, over the last two quarters.

Deca Division. Deca Division has outperformed the industry average. You see the index, the ABRAMAT Index, the average of the segment, right? So, you will see later that that is having a better performance than the average of the segments.

On the Wood Division. Despite less fixed cost dilution, the Wood Division has significantly reduced costs. So, as you can see, we had lower volume this quarter. Even that, the Wood Division could reduce the fixed costs, right, so with lower cost dilution. And finally, the last one, regarding SG&A, a reduction in general and administrative expenses. So, we could see this in two slides before.

So, on the next page, page number 17. Here, we have the consolidated financial figures of Duratex in this third quarter. The net revenues was BRL 967 million in this quarter. The amount was around 4.5% lower than the second quarter 2016. And below the breakdown per division: Wood Division Brasil, the net revenue was BRL 532 million; Tablemac, BRL 95 million, and finally, Deca Division, the net revenue was BRL 340 million.

Below you see the net revenues breakdown in this third quarter. Domestic market represented 82% of the revenues and foreign market represented 18% of the revenue. But it's important to mention that year-to-date 2016, the foreign market represent 20% of the revenues. This is part of our strategy to increase revenues, and it's coming from out of Brazil through Tablemac plus export.

So, please turn to page 18. Right on here, you have the volumes, the EBITDA, net profit, and recurring EBITDA margin. So, Deca's volume in this third quarter 2016 was 6.6 million items. The volume was 1% higher than the second quarter 2016. Regarding Wood Division, the volume this quarter was 580,000 cubic meters. The volume was 5.4% lower than the

volume of the second quarter 2016. However, recurring EBITDA increased from BRL 172 million to BRL 186 million. And the recurring EBITDA margins had the same movement, increased from 17% in the second quarter to 19.2% in this third quarter 2016.

So, regarding net profit. The net profit of Duratex in this third quarter 2016 was at around BRL 30 million. Basically, BRL 10 million came from the recurring net profit regarding our operational business, right, and the rest, BRL 20 million came from our land that we sold close with Itapetininga in this third quarter 2016.

So, on the next page, page number 19, we start the discussion about the Wood Division, right? First of all, let's start the discussion with the Brazilian wood panel market. This slide is not only about Duratex but about the panel market in Brazil. So, year-to-date 2016 against year-to-date 2015, the MDF market has decreased 80% (sic) [8%] (16:43), while MDP year-to-date 2016 against year-to-date 2015 has increased 0.5%. In the average, the market has decreased at around 4.5%.

So, please turn to page number 20, and here, the idea is to talk about the operational performance. The shipment in this third quarter 2016, the volume was 580,000 cubic meters. The amount was around 5% lower than the second quarter. And when you compare year-to-date 2016 against year-to-date 2015, the volumes have decreased 5.7%, a little bit higher than the average of the segment. Why? Because the idea is to maintain the price instead of gain market share.

In the chart beside, you have the occupancy rate of the Wood Division in this quarter. Including Itapetininga, on MDF, the occupancy rate was 68%; without the Itapetininga, was 89%. On MDP, including Itapetininga, was 54%; without Itapetininga, 70%. While hardboard was the same, 89%. Why? Because there is no hardboard line in Itapetininga.

So, right now, please turn to page number 21. And here, we will discuss the financial performance of Wood Division. So, the net revenue of Wood Division in this third quarter 2016 was BRL 627 million, around 6% lower than the second quarter.

However, when we compare year-to-date 2016 against year-to-date 2015, the net revenue has decreased only 3.6%. In the chart beside, you have the recurring EBITDA. The EBITDA in this third quarter 2016 increased from BRL 124 million to BRL 135 million, an increase of around 9%. While the EBITDA, we saw the same movement. The EBITDA increased from 18.5% to 21.5% in this quarter. That's it about the Wood Division. Let's change to the Deca Division.

So, on the next page, page number 22, we'll discuss about Deca. First of all, we have the ABRAMAT Index. ABRAMAT Index measures the growth in the revenues of building materials in the domestic market. As you can see, year-to-date 2016, the ABRAMAT Index has decreased 12%. You see in the few page that Deca's performance is better than that.

So, on the next page, page 23. And here, we have the operational performance of Deca Division. So, the volume of Deca in this third quarter 2016 was 6.6 million items. The volume was around 1% higher than the second quarter. However, year-to-date 2016

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against year-to-date 2015, the volumes have decreased 5.5%. The chart beside, you have the occupancy rate of Deca Division in this quarter. Sanity ware was 59% and metal fittings was 79%.

And finally, the last slide about Deca, slide number 24, we have the financial performance of Deca Division. The net revenue of Deca Division in this third quarter 2016 was BRL 340 million, right? So, 1.4% lower than the second quarter. However, year-to-date 2016 against year-to-date 2015, the revenue has decreased 5.4%. In this index, we can compare with ABRAMAT. So, as you remember, ABRAMAT has decreased at around 12%, and Deca has decreased by only 5.4%. What you can conclude with these numbers that Deca is gaining market share against our competitors. In the chart beside regarding recurring EBITDA, the EBITDA of Deca increased from BRL 48 million to BRL 51.2 million, an increase of 6.8%, while EBITDA margins increased from 13.9% to 15.1% in this third quarter 2016.

So, please turn to page number 25 and on the next three pages discuss the CapEx, the corporate debt, and the message of the company. So, regarding CapEx, we have now seen that we are reducing our sustaining CapEx from BRL 420 million to BRL 380 million. This show our efforts to reduce the CapEx for our minimum sustaining CapEx. In addition to that, we expand BRL 93 million to do the tender offer of Tablemac. Right now, we have 90.9% of the company, okay?

So, on the next page, page number 26, we have our corporate debt. The net debt of Duratex in the third quarter 2016 has increased BRL 54 million from BRL 2.073 billion to BRL 2.127 billion. And the net debt-to-EBITDA in this quarter increased from 3 times net debt-to-EBITDA to 3.28 times net debt-to-EBITDA basically due to a reduction in our EBITDA. Below, you'll see our amortization schedule. We have BRL 1.3 billion in cash.

So, you can see we have enough cash to pay off all of our debt in 2016 and majority of our debt in 2017. This side, we have our debt composition. In domestic currency, we have 70% of our debt, basically working capital and BNDES loans. And we have 30% in foreign currency, basically Resolution 4121 (23:54) that we swapped to BRL. So, we think are important to mention here that we don't have any exposure in other currency than BRL.

And finally, on the next page, page number 27, the last slide, we have the management message. So, regarding environment, the demand remains weak. So, we can say that the demand stabilized but in a very low level so far. But the economic indicators suggest a gradual rebound. So, when you analyze some index that's very important for us like consumer confidence, consumer confidence has increased over the last month. The inflation forecast, we are seeing a reduction in inflation forecast. And finally, in this month, the Brazilian Central Bank start to cut interest rate, and the forecast is that the Brazilian Central Bank will remain this movement to cut interest rate. This is very positive for us.

So, regarding our internal agenda, as we mentioned before, first one, the main focus is on cost cutting and efficiency as you can see this in our three projects: Integra, OBZ and SGD, and Logistic. The second one is regarding our cultural project. As I said before, this can be a turning point to the performance of the company, right? So, this project is very, very important.

And finally, as I mentioned during the net profit announcement, we are reviewing our land and forestry assets, right? So, we are seeing some opportunities maybe to sell some lands. We have excess of land and we're analyzing opportunities to sell wood to third parties like paper segments.

Finally, the final message of the company is this change will make Duratex even stronger, more competitive, and more efficient.

So, thank you very much for your time. 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 Juan Tavarez with Citi.

Q - Juan G. Tavarez {BIO 15083199 <GO>}

Hi. Thank you. Good morning, everyone. Just my first question, if you can talk a little bit about the wood panel market. And it appears that in the third quarter, you could lose (26:47) some market share but you (26:50) that with better pricing. I'm curious, how are you seeing that into the fourth quarter and if you can confirm to us what your market share is today and what that trend could be into year-end?

And then second, if maybe you can talk a little bit about just your amortization schedule of your debt. I'm actually on slide 26, here you have a big payment coming for the fourth quarter? I'm curious if you're going to be rolling that over or paying it down completely with cash, just get a little bit more color on your liquidity as well. Thank you.

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

Thanks for your question, Juan. So, regarding the wood market, so we saw a very tough time during the third quarter. Basically on September, we saw some pressure on price, right, and Duratex decided to maintain the same level of price during this period, okay? And so far, in October, we are seeing a small improvement in the market, okay, a small improvement in the demand, marginal so far, and I mean - and this pressure on the pricing side is decreased a little bit, right?

So, what I can say is there is no room to increase price certainly over this quarter, but we believe that the worst period was during September 2016, right? So, we don't believe that we will see some discounts in price during this quarter. But of course, the uncertainty is so high, so this is our scenario, okay? So, we are seeing some competitors giving some discounts, right? Maybe to gain market share, but this happened in the final of September. During October, this movement reduced a little bit, okay?

So, regarding our amortization schedule, so, what I can say so far that we analyzed some alternatives, right, so to take loans, right, so maybe to issue some debts or something like that, right? I mean, what I can say is - I mean, we are doing some efforts, right, so to increase our cash position in near future, okay?

Q - Juan G. Tavarez {BIO 15083199 <GO>}

Okay. Thank you very much. And maybe if you can just confirm what is your market share today in wood panels in MDP and MDF?

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

Okay. Our market share right now was at around 30%, okay? Historically, was 35%, okay? We have 40% of capacity share, but normally, we're at 30% (29:43) of market share. And nowadays, due to (29:47) new line, (29:50) new line, and our policy to not give some discounts, we, in the last month of September, our market share was around 30%.

Q - Juan G. Tavarez {BIO 15083199 <GO>}

Okay. Thank you very much. Very helpful.

Operator

Our next question comes from Steven Rivoir, Invesco.

Q - Steven Rivoir {BIO 18841952 <GO>}

Hi. Thanks for taking my question. I just had a quick question on the premature redemption of the Agribusiness Receivable Certificates. Is that included in your amortization table or is that additional use of cash that you're going to need to make in the fourth quarter on top of the BRL 918 million? Thank you.

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

Thanks for your question, Steven. I mean, our amortization schedule in 2016 is including the CRA amortization that happened in beginning of October, okay? So, there is no (31:12) in our cash position because this event happened in October. But we reclassified this debt to short term in 2016. So, answer your question in this number, BRL 900 million is including CRA, the bond issue that we realigned (31:36) in October, okay? But I would like to say that given the situation, we analyze a lot of alternatives, right, so to reconfirm (31:46) our cash position, okay? Probably in the near future, we will disclose more about that. So far, I can't say more, okay? Thank you.

Q - Steven Rivoir {BIO 18841952 <GO>}

Thank you.

Operator

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

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

Thank you, everybody. So, myself and (32:37), our IR team here in Duratex, we are available to answer more questions if necessary over the next month, okay? Thanks very much for your time.

Operator

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

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