Elementia 1Q18 Conference Call Transcript

Carolina: Good day. My name is Carolina and I will be your conference operator. At this time, I would like to welcome everyone to the Elementia Earnings Conference Call. All lines have been placed on mute to prevent any background noise. There will be a question and answer session after the speakers' opening remarks, and instructions will be given at that time. Thank you. I will now turn the call over to Alfredo Recke, Elementia's Investor Relations Officer. Please, go ahead.

Alfredo Recke: Thank you, Operator. Good day, everyone, and welcome to Elementia's First Quarter 2018 Earnings Conference Call. Joining me is our Chief Executive Officer, Fernando Ruiz Jacques, and our Chief Financial Officer, Juan Francisco Sanchez Kramer.

Please be advised that this call is for investors and analysts only. During this call, we will be discussing Elementia's performance after the earnings release issued yesterday after the close. If you did not receive the report, it is available on our website and in the investor relations section or call i-advize to New York at 212-406-3694.

Let me remind you that forward-looking statements may be made during this conference call and they are based on information that is currently available. Please refer to the earnings release for a more detail and full disclaimers. All figures discussed in Mexican pesos unless otherwise stated.

It is now my pleasure to introduce Fernando Ruiz Jacques, our CEO, who will provide Elementia's strategic overview for the following years. Fernando, please go ahead.

Fernando Ruiz: Thank you, thank you, Alfredo, and welcome, everyone. I would like to take this opportunity to give you an update on the evolution of our corporate strategy, and then allow Juan Francisco to dive into our results.

We have made significant progress in the last 18 months, and I think it is important to give you a clear idea of where we are and where we are going. It is a priority for us that our shareholders understand our value proposition for the long term, which is creating a company that delivers building solutions, not just products, in order to influence the construction value chain and improve customers' experiences. So, please bear with me for a few minutes to take you through step by

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step through our recent accomplishments, our current position and future steps.

So, let me begin by taking a step back to 2017. Last year, we made a bold move from being a company with three divisions focused practically on products towards a more integrated one that delivers products and solutions for both the traditional building as well as to a more industrialized and sustainable building system. This is what we call Elementia 2.0; and in the near future, we expect to capture additional margin from all stages of the value chain.

In our last call, we mentioned that during 2017, we made the foundation for the continued growth for Elementia, and in 2018, we aim to strengthen our growth path by focusing mainly on 6 pillars:

First, ramping up the capacity expansion at Tula. Two bringing back Giant's assets to industry standards. Three, ramping up the newly reopened Indiana plant. Four, starting up Costa Rica's grinding facility. Five, continue to deleverage the company through cash flow generation; and what excites me the most...six, execute the pilot project for Elementia 2.0.

So, diving into Elementia 2.0, our main goals for 2018 is to test drive this concept in full, by our philosophy of being an agile company, take quick action in fine tuning this business model.

This year we have struggled with many challenges. Our consolidated results for the quarter reflects some of our struggles, but we acknowledge that change and progress doesn't come easily.

For instance, our U.S. Cement operations had great start. For instance, we made great CapEx investments; we normalized operations, recovered clients, and reinforced the entire team. Unfortunately, our financial results for the quarter were overshadowed by effects of a harsher winter and by an unplanned 3-week outage in South Carolina facility caused by our yearly maintenance process, in which we hired a specialized contractor to do it.

Analysis of the root cause will soon clarify the natural questions: why, how, and who. However, the situation forced some of our clients secure their volume with other industry players. At this point, we cannot regain the lost volume and might see further impacts on future volume.

Now on the upside, this facility is up and running again as of middle April, thanks to the fast action made by our U.S. team in solving the problem. Nevertheless, we are staying proactive in avoiding this kind

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of outage in the future. So we've implemented a redundancy mechanism consisting of importing cement to the U.S. to ensure supply continuity and provide, reliability to our customers. In fact, we already signed our first contract under this mechanism with a maritime terminal in the USA. We are confident in our U.S. team to recover from this unfortunate incident, and our customers know they can rely on us in the future.

We work on (inaudible) when compared to the performance of the industry, consumption in the southeast was 10% lower that last year according to the GCH and Portland Cement Association. However, our (inaudible) is 8% higher.

Our main goal for the U.S. cement operation has always been maximizing profit. In 2017, we focused on integrating Giant into Elementia and we did it. Our goal for 2018 is to start market share recovery by regaining customer trust through upgrading our supply reliability, consistent product quality, while bringing back the assets to industry state of the art standards.

Market outlooks in the U.S. remain positive in terms of volume. The yearly demand and price trend has been growing according to the expected 5% and 3%, respectively. As such, we believe 2019 will be the right time to increase market share and set the foundations to start closing the existing price gap between our product and that of the rest of the industry in 2020. We have designated a 3-year CAPEX plan in which 2017 took the bigger bite.

Now, moving to the Mexican cement operations.

The cement capacity expansion in Tula was a success in 2017 thanks to the high acceptance of our product in the region and the new sack-bulk mix.

2018 demand is expected to remain strong for the first half; while we foresee a bumpier road for the second half and 2019 mainly due to the presidential elections during the second quarter, which tend to generate a sharp decrease in expenditures in government infrastructure projects and uncertainties related to NAFTA. Nevertheless, we want to maintain our competitive levels high by implementing a contingency plan consisting on cost reductions and developing only those projects essential to maximize profitability.

If everything goes according to plan, we believe we can reach full potential at Tula by year-end. Remember that we are long-term visionaries, so despite 2019 expectations, we are most excited for

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what we see in 2020. I can assure you we are developing plans according to that and expect to give you good news on this matter.

On another highly positive note, the grinding project in Costa Rica is going according to plan and we expect to launch operations by 3Q18. This business model is an important piece of the puzzle as it yields synergies through vertical integration among its Cement and BuildingSystems Divisions. Elementia currently has cement operations in the U.S. and Mexico through several brands, such as Giant Cement, Keystone Cement, Dragon Cement and Cementos Fortaleza; and our mission is to integrate them all with our other products in our portfolio.

Moving on to the Metal Products Division. 1Q18 numbers are a bit weak, but please bear in mind that this is mostly related to an unfavorable comparability effect as 1Q17 reported double-digit record highs in the history of Elementia. Nevertheless, we anticipate a more favorable market environment and good growth prospective in terms of volume for the remaining of 2018. Many of our clients' demand have increased, and in addition to the oil and gas trends (which have proven to be directly correlated to our industry) give us the confidence that Nacobre will begin a period of recovery during 2018. Also, it is important to mention that the three facilities are almost at full capacity.
Our strategy for Metal Products is based basically on 2 growth engines:

- First, focusing on higher value products that reflect our ability to innovate within mature markets and most importantly expand EBITDA levels; and
- Second, optimize our costs through a method we call "Full Potential", comprised by 2 parts working in parallel. One part, focuses on optimizing costs in the areas of purchases, logistics, capacity utilization and products, seeking an additional 15% in EBITDA within the next 18-36 months. The second part, which was internally developed, is in the works of validating operations throughout the 3 divisions in terms of processes as well as purchase and inventory management.

Turning finally to the BuildingSystems Division. The division's growth and recovery at a consolidated level continues to be supported by the successful results of the "Go-to-Market" strategy. However, due to the seasonality effects in the U.S., unfavorable macroeconomic conditions in Latin America, our decision to reduce inventory (which increased costs), additional expenses derived by staff reduction, the Terre Haute reopening process; and having one our main competitors resolving its inventory problems and recovering some of its clients, results were down compared to 1Q17; yet are significant better compared to 4Q17.

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Keeping these challenging scenarios in mind and our long-term vision, our strategy for the Building Systems continues to be set on lightweight construction systems. We did good progress last year by shifting from corrugated panels to flat panels (which are more aligned to the light vertical construction market).

This innovative change comes with a cost. In 2017, we invested a little bit over USD$20 million and incurred in additional costs derived from reprocessing caused by operations that are not yet 100% stabilized. These costs are reflected on both 4Q17 and 1Q18 results.

On the upside, we've had high acceptance on flat panels and all products using synthetic fibers. This promising material gives great advantages for both distributors and final users. Distributors benefit from its elasticity that translates to less breakage, while consumers benefit from lower costs without having to compromise the aesthetic appearance.

In 2018, we want to consolidate our strategy by further strengthening our competitive advantages and, just like we are doing in or other divisions, proactively anticipate challenges.

For instance, we want to continue leveraging on innovation and improve the installation phase within the construction process. Our R&D centers have developed special glue that pragmatically simplifies the installation phase as it allows having to make less pressure on panels compared to the traditional way of installing panels with screws.

Finally, in line with generating EBITDA growth, we are rightsizing this division by 14% and (inaudible) people of 2,800 and shifting it towards a more horizontal, direct and focused structures.

We expect savings of more than Ps. 150 million to help partially offset lower volumes in this division.

To summarize, there are 4 main messages I want you to take with you:

1. We have a clear vision of who we want to become and the roadmap, capabilities, team, infrastructure and technologies that will take us there.
2. We've built a strong financial basis to support our strategy by staying committed to our financial and capital allocation discipline.

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3. We are aware of the fact that the path towards Elementia 2.0 is a bumpy road (in some divisions more than others, like Building Systems) but we have taken action to smooth it out as much as we can.
4. And finally, we are being proactive by anticipating the possible challenges we might face in 2018, and at the same time implement preventative measures.

With this, I conclude my remarks, and now I turn the call over to Juan Francisco Sanchez Kramer for further details on our financials. So, please, Juan Francisco, go ahead.

Juan Sanchez: Thank you, Fernando, it seems like we are having problems with our connection. So I would kindly ask you to reconnect, we will cut out, and be back, please.

Operator: Thank you. Please stand by.

Please stand by. Your program will continue shortly.

Please stand by and thank you for your patience. And, you may continue.

Juan Sanchez: Thank you. Thank you all and sorry for the inconvenience. I hope you can hear us better now. So, I will like Fernando to, to give kind of a summary, not to give you more than you need. But, we believe that it is worth going back a little bit. So, please, Fernando, thank you.

Fernando Ruiz: So, basically, the four messages I wanted to leave you with, as I was saying before, is that we have a clear vision of who we want to become and the roadmap capabilities team, infrastructure and technologies that will take us there. Second, we have built a strong financial basis to support the strategy by staying committed to our financial and capital allocation discipline. Third, we are aware of the fact that the path towards Elementia 2.0 is a bumpy road, in some divisions more than others, like building systems. But, we have taken actions to move it out as much as we can. And, finally, we are being proactive by anticipating the possible challenges we might face in 2018 and at the same time, implement preventive measures.

So, with this, I conclude my remarks, but if you have had problems hearing me, what I spoke before, please let us know and I can repeat my script again. So, please let us know. Meanwhile, I pass, I turn the call to Juan Francisco Sanchez Kramer for further details on our financials.

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Juan Sanchez: Thank you, Fernando. Going straight to financial performance, 2018 started with a solid quarter that included continued market economic volatility in several countries in which we operate and a harsher winter in the U.S. compared to that of 2017. Nevertheless, consolidated revenues posted a growth of 5% to reach 6.9 billion for the quarter, mainly due to our continued efforts to optimize the utilization rate at Tula cement plant and our focus on higher value-added products in metal products division, along with high copper prices, which both posted double-digit growth of 14 and 15%, respectively. These results helped offset a 30% decrease in Building Systems.

In terms of EBITDA, this line item posted a slight decline of 3%, reaching $923 million; with an EBITDA margin of 13%, driven by the aforementioned headwinds: a harsher winter in the U.S., macroeconomic volatility in the Andean Region, and volatility in the Mexican market due to the NAFTA negotiations and the election process. EBITDA was also impacted by changes in internal processes. For example, first as we mentioned, the technological change and its learning curve, came with a different cost structure, and first expenses related to the rightsizing we started in Building Systems. The second impact came from our focus on generating cash flow by reducing inventories. We reduced production rates in several facilities that helped us reduce inventories, but reduced the absorption of fixed costs. I would like to emphasize that we are taking all necessary steps to improve our short-term performance while remaining committed to our long-term strategy; and therefore, our growth plan for 2020 EBITDA remains the same.

Going further in detail on the performance of each Division:

The performance of the Mexican operations for the Cement Division was once again outstanding. It posted 39% improvement in revenues and a high of 78% in EBITDA while margin reached to 46%. There is no doubt that this continuous growth has been thanks to our visionary strategy of ramping up Tula's capacity expansion since mid-2017 by changing our sack/bulk mix and optimizing utilization at the plant. Our great volumes also show the strong acceptance our high-quality product along with favorable price trends.

EBITDA levels benefitted from higher operating efficiencies, state-of-the-art technology and lower energy costs. We are committed to continue implementing these strategies to help us keep a stable EBITDA during the challenges we'll face in the following quarters.

For the U.S. Cement operations, revenues reached $778 million during the quarter as 2018 winter season was much harsher than the

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one faced last year; therefore, having a greater impact on year-over-year comparisons. Moreover, revenues were also hit by an unplanned halt in our South Carolina facility due to a failure in the grinding process while the contractor was commissioning operations after the yearly maintenance outage.

Is also important to highlight that, according to the PCA, overall consumption in the south east coast decreased around 10% for January because of weather, while our volumes increased 8% in the month and we believe that it was showing our trend of a positive performance for the quarter before this unplanned outage.

As we have also mentioned, 2018 is the second year of our 3-year plan to bring back the assets to industry standards,that is the foundation to have reliable operations and quality to begin regaining our fair market share. This plan includes both CAPEX of 80 to 90 million and OPEX.

Moving to Metal Products, the Division posted double-digit growth of 15% in revenues mainly due to the reference price of copper (that is a 12% increase QoQ). Contrary, EBITDA suffered from the unfavorable effect on inventory valuation, reporting a slowdown of 25% or 18% in dollar basis. As we mentioned in the past, we add certain margin to the copper price in dollar per ton that allows us to transfer commodity volatility to the customer.

However, considering the transformation time-frame, this strategy benefits us in times where copper prices go up and/or when the Mexican peso depreciates – an effect we had in 1Q17. However, this quarter, while metal price trends continued to go up, the Mexican peso appreciated against the U.S. dollar – resulting in an unfavorable effect.

Our purpose in 2018 is to recover EBITDA levels by optimizing capacity utilization in both manufacturing and logistics processes; as well as by increasing export volumes through our newly expanded capacity for higher value-added products.

Finally, the Building Systems Division at a consolidated level was down by 13% and 41% in both revenues and EBITDA. Given that the US operations have become more relevant, when seen in dollars, the variation is 5% and 36% in revenues and EBITDA, respectively. Obstacles were present in all regions, from higher competitive levels and a harsher winter in the U.S. to political uncertainties in Mexico, Peru, Ecuador, Bolivia and Colombia as well as to challenging macroeconomic conditions in the Andean Region overall. Moreover, EBITDA levels were also shaken by costs derived from changes in technology implemented at our facilities and those derived from being

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in the learning curve. Also, lower capacity utilization rate focusing on lowering inventories which affected the overall cost due to lower fixed costs absorption.

On the upside, these changes represent a small cost compared to the returns we expect to obtain from shifting our focus towards flat panels and synthetic fibers from corrugated panels. We will continue to see some of these effects throughout the rest of the year; however, we expect the impact to be less quarter to quarter – to the point of reaching stabilization in the near future. A little piece of additional information on the construction trend with light building systems is that, according to the World Bank, average urban population in the countries where we operate in, grew 15 times when compared to rural population growth in 2017. Furthermore, according to the census bureau in the U.S., in 2017, the growth trend for light construction was 4 times higher than the growth trend for traditional construction.

Before concluding, I would like to highlight that at a corporate level, we are taking special initiatives to strengthen our financial position in both short and long-term within highly volatile markets. Some of our most important steps taken were:

1. Balancing our liabilities, assets and cash flow generation in terms of currency;
2. Protecting the company in the face of up-wards trend in interest rates no more 70% of the debt is now fixed rate; and
3. Exchanging short to long-term debt.

We have a clearly defined strategy and seek to maximize all opportunities to continue profitable and responsible growth in the long-term. Into 2018, we are paying close attention to our capital allocation based on return over invested capital, keeping a strong balance sheet supported by our financial discipline and continuing the operating efficiency.

Now, I would like to return the call to Fernando for final remarks.

Fernando Ruiz: So, thank you, Juan Francisco, and before we take your questions, I just would like to make sure you understand correctly where we're standing at and where are we heading. So, I would like to summarize what you should expect for the rest of this critical year.

So, let me start with the U.S. cement. We strongly believe we are on the right track for improvement. Today, our team is complete. We've finished phase one of our three-year plan. We deployed our planned Capex budget of 30 million and our customers' relations have improved dramatically.

In Building Systems, we have solid expectations for the second half of the year. In the U.S., we are past the seasonally low period of winter. Indiana is now operating below break-even and it is currently in the ramp-up stage, but this will begin to revert. Our main competitor has recovered part of its volume and has been extremely aggressive. There have been low consumption levels in the U.S., which is affecting Central America and Mexico. Housing starts have declined between December and February, and beginning to rebound in March, but overall above the prior year. And, our go-to-market strategy is working, and we have rebuilt our team.

Going to building systems Latin America, in Mexico, we, as all other companies, are seeing a period of instability from NAFTA and the elections. Government spending is practically non-existent for now, so we're working to reduce our dependence on any kind of government projects. The good news is that our sales network has grown more than 35% versus 2017, and more than 70% versus 2016. So, really has not been enough to offset the government spending, but we're on the right track.

And, moving to the Andean region, the economic recession and political instability in Columbia, Ecuador, Bolivia and Peru is translating in lower purchasing power and weaker consumption levels. And, finally, we're migrating from corrugated sheets to flat panels.

So, what is our action plan? Our action plan is due to high inventory levels, and in order to reduce our working capital, we decided to halt production, which raised our production costs due to a lower absorption of the cost. We, as we speak, we're conducting a right-sizing through the reduction of about, more or less, 16% of our headcount in Latin America. This implies, of course, some restructuring cost. And, also, we are rationalizing capacity in Latin America, which implies the closing of three plants in the region.

The annualized savings we expect from these two action plans is estimated about 150 million pesos. The second quarter will be a period of transition with cost and expenses related to these restructures and capacity rationalization. And, we're taking these fundamental decisions part of a plan to recover our growth track beginning in the Third Quarter 2018.

Lastly, we're conducting a rational analysis to determine which businesses are a strategic fit, which are an economic fit, in order to identify what are our core operations and non-core to adjust our plans accordingly.

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So, that concludes our comments. So, now we're happy to take your questions.

Carolina: And, if you would like to ask a question, please press the star and one on your touchtone phone. You may remove yourself from the queue at any time by pressing the pound key. Once again, that's star and one to ask a question.

And, your first question comes from Mauricio Serna with UBS. Your line is open.

Mauricio Serna: Hi. Good morning, and thanks for taking my question. Apologies, I wasn't able to connect to the call earlier, but just wanted to ask on Mexico, well, on both of the cement businesses, first on Mexico. You know, pretty impressive the volume increases you delivered, so, I mean, I just was wondering, I guess we could expect another strong trend for the second quarter and maybe much more moderate in the second half as you complete like the ramp-up of the plant, of the capacity expansion. So, just wanted to confirm that. And, also, I don't know if you could share the pricing you've done if you did any in the first quarter, and if not, if you're planning to do so in the second quarter.

And, just very, just on the U.S., if, I mean, I hear, you know, you have the plant, the outage of the, unplanned outage of South Carolina. I just wanted to understand, you know, as it continued throughout most of April, how much impact could we actually expect in the operation, on the performance in the second quarter for, because of this outage.

Juan Sanchez: Thank you, Mauricio. Going first to cement in Mexico, in the first quarter, we did, or the industry overall, they have a price increase that we show in our figures also. We are kind of hoping to have another price increase in the second quarter, but it hasn't happened yet. As you well pointed out, if it doesn't happen within the second quarter, we believe it will be harder to see it in the rest of the year.

Now, in terms of volumes, the straight answer is yes, we are hoping or seeing strong demand for our products in the second quarter also. But, in a comparison basis, the figures will be less, let's say aggressive in the second half, because we started the full operation of the expansion in the third quarter of last year.

Now, going to the U.S., as we mentioned, the unplanned halt was from March 26 throughout April 13. So, operations have been reestablished. Nevertheless, we believe that it might take time to recover all the affected accounts, and so we are expecting low but steady volume recover. And, therefore, we're expecting some

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additional impact at least in the second quarter. It will have, we believe that it will be smaller from the third quarter and on, but it might still have some impact for the rest of the year.

Mauricio Serna: Okay. I mean, just to have an idea on like how much of your U.S. volumes does that plant represent in terms like of like, yeah, the volume that you serve, so you provide there?

Juan Sanchez: This facility accounts for roughly 40% of our total U.S. capacity, and what the one that was most affected because of the winter. The other two facilities were more on kind of the seasonality, but in the southern part of the country, or the East Coast in particular, there was a much harsher winter than, than normal. So, we have double impact in this region because of this and the outage. So, just last week there was still snow in this region.

I would point, as we tried to show, is that before this our volumes were growing, while the industry, at least in January, show it a declining consumption because of winter. So, the message is we were on the right track and we believe that we can recover that track by year end.

Mauricio Serna: Got it. Thank you. And, just very lastly, on your, on what you said on the restructuring, I just, because I didn't hear well, is that going on across all the divisions and like which period should we see the effect, you know, of restructuring expense on the P&L?

Juan Sanchez: So, I mean, the restructure is mainly focusing on building systems. We acknowledge that we have had some problems in the division coming from the change on the, on both the strategy moving from flat panels to corrugated and—sorry, from corrugated panels to flat panels—that is aligned to our strategy of light building systems. And, also, this comes along with a changing technology. So, we have been hit by additional costs in the change of technology and the learning curve, but also from let's say outside conditions that are affecting our market. Aligned to this, we are right-sizing the operations in Latam and also, we are right-sizing and rationalizing the capacity, the installed capacity. This means that we are reducing the headcount on roughly 16% in the region, and also, we are idling some four facilities in the region.

To your specific question, we will have impact, or we already have some impact on the right-sizing in the first quarter and will have additional impact in the second. And, most of the impact of the capacity rationalization will come in the third quarter.

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Now, what I would like to highlight is that from these two actions, we are expecting a savings of more than 150 million in a yearly basis that will begin to be…

Mauricio Serna: Pesos?

Alfredo Recke: Yes, pesos.

Juan Sanchez: …seen, that will begin to be seen in the third quarter this year.

Mauricio Serna: Great. Got it. Thanks.

Juan Sanchez: Thank you.

Fernando Ruiz: Thank you.

Carolina: And, your next question comes from Vanessa Quiroga with Credit Suisse. Your line is open.

Vanessa Quiroga: Hi. Thank you for the call. My first question is regarding several follow-ups. On the U.S. cement, can you clarify that those accounts that you lost, how much they represent of total sales? And, also, if you can update your Capex estimates for the U.S. cement division, please?

Juan Sanchez: Hi, Vanessa. Thank you for the question. What we can tell you is that roughly 60% of the total accounts of the southeast region were affected because of this outage. And, we have already regained some of them, of those, but given that the customers were needing supply, we even helped them to find other sources of cement. And, they have gone, of course, with volume from competitors or other players. That, by the way, we're playing a very fair game, we must say that. So, it will take time to recover all those accounts, because some of them did agreements for more than the quarter.

To your second question, Capex or planned Capex for the U.S. cement in this year is around US$25 million for the full year. So, we keep on with the three-year plan that we started.

Vanessa Quiroga: US$25 million Capex for the full year?

Fernando Ruiz: That is correct.

Vanessa Quiroga: Okay. Okay. And, regarding U.S. systems, Allura, I think you mentioned a loss of market share. Can you, can you give us some color on what is happening in the competitive landscape in the U.S. building systems?

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Juan Sanchez: Sure. I mean, first of all, the U.S. building systems was affected also by weather, by the winter, harsher winter. Second, it was also affected because of the recovery of a competitor that recovered some of their lost accounts. We managed to keep some of those, too, and we believe that we will continue strengthening our position. The good news about this is many players that until last year hasn't been with us, has already seen what we can do and have already seen that we can be a very good option to supply. So, we believe that the volumes will balance further as the year comes by.

It is also important to highlight that EBITDA generation was affected because of the start-up of the Indiana facility. It is not running yet at a break-even point, so it is costing. We believe that we are the right track and we believe that we will get to this break-even point in the coming months.

Fernando Ruiz: And, just to expand on Juan Francisco's comment, Vanessa, it is important for you to understand that last year, first quarter, the first thing, it was not a white Christmas, so volumes were, I mean, construction went completely different from this year. I mean, there was a lot of construction last year. And, on the other hand, our main competitor had production problems last year, so we took many of those accounts, no?, and once they reestablished their operations, many of the, because they had contracts, many of those distributors went back to them. So, that's more or less what has happened.

Vanessa Quiroga: Okay. And, regarding, so on market share there, what's your estimate of market share right now? What's the estimated market share that you have in U.S.?

Juan Sanchez: We are, I mean, the latest figure would be that of 2017. As you know, the Bureau Census takes some two months to publish data in the U.S. So, anything that we might say now is up to January, and up to January, our market share was about 11%.

Vanessa Quiroga: Okay. Okay. And, on the, in Latin America building systems, what, you were explaining about the other, the new technology, the new product that you have. The cost structure of this product, is that, I mean, would you expect a lower margin from this new product, or is it the impact on the cost structure is just temporary?

Fernando Ruiz: No. Today, we have an impact in the cost structure. Today, it's 12% higher, no?, it's costing us. We are on the learning curve, and we expect to, to be improving this cost in the near future. I mean, we're very happy about how, how fast we have transitioned to this new technology. But, today, the cost increase is 12%. We expect, as I told you, to improve this, but at the end of the day, I think it will cost a bit more than used to cost, the former technology. So, as Juan Francisco was saying formerly, we are switching the technology due to, from this movement from corrugated panels, which is basically for roofing, to panels, no?, which is basically for light-weight building solutions, no?, light-weight building systems, where we tremendously see the industry is going. As you know, basically, the population in the world is growing, is growing a lot. People are moving from rural areas to urban areas, so construction is going up. So, this industry will grow dramatically. So, we, I think we are taking the correct decisions. It's hurting now, yes, it's hurting, but we're here for the long term, so we are convinced that it is the correct decision and we're on our way there.

Vanessa Quiroga: Okay. Are the competitors in the light-weight panel industry different from the corrugated product?

Fernando Ruiz: Well, it's a different market, Vanessa. The corrugated product is for roofing, as I told you, so the competitors are very different from the ones that we have in roofing, the ones that we have in the panels, in the flat panels. So, it's completely another industry where we, so we're making, I mean, we will keep on selling, of course, in this corrugated panel industry, no?, where we also implemented this new technology; because, this new technology gives, gives a better flexibility to the end product, so we have less breakage. So, the distribution network is very happy, because they can manipulate it better. So, it's completely two different markets. So, basically, what we're doing is we will keep on serving that market, which will not grow a lot. So, if you have this vertical construction each time there will be less roofing, if you want to call it like that. So, that is why we're taking the decision and moving to this new, this new market which we see it has a tremendous future.

Vanessa Quiroga: Okay. Okay. Thank you.

Fernando Ruiz: If you want me to be more specific, Vanessa, for instance, in the roofing, we compete against galvanized products or plastic products or cardboard products. And, in the light-weight building systems, we compete against cement panels, we compete against drywall, etc.

Vanessa Quiroga: Okay. Okay. Yeah, that's helpful.

Fernando Ruiz: Okay.

Vanessa Quiroga: Okay. That's helpful, yeah.

Carolina: And, your next question comes from Cecilia Jimenez with Santander. Your line is open.

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And, Cecelia, your line is open.

Fernando Ruiz: She’s not there, so you want to move on to the next question then?

Carolina: And, your next question comes from Hernan Kisluk with Met Life. Your line is open.

Hernan Kisluk: Good morning, gentlemen. Thank you for taking my question. It’s relating to the working capital, which you have done a great job this quarter. And, I’m wondering if you could provide more color, if there is more room to go regarding working capital reduction, and what will it come from.

Juan Sanchez: Sure. Thank you, Hernan, for your question. Yes, there are further opportunities regarding working capital, mainly in inventory. And, let me discuss a little bit further than this. For the technology change that we did in building systems, we created additional inventories, which now we are depleting. Once that we complete that depletion and once that we have, we complete the learning curve on the new technology, inventories will go down even further. The decision that we took is protect our customers and protect the market, and now we are going in the right direction and you will be seeing further improvement there.

We are not only focusing on inventories for building systems but all divisions. Inventories in metal products will also come down and you will be seeing it. Cement in the U.S. also was higher on inventories, because of the seasonality within the year. So, and because we, we create inventories in order to have a product available for the market during the, during maintenance outage. They will come down also.

And, also, it is important to highlight that by the end of last year, we began implementing sales and operations planning for all our operations, and we are now much more focused on aligning consumption with production. And, we are also working deeply with big data analysis and the outcome will continue to be seen in this regard also.

Hernan Kisluk: Okay. Thank you very much, Juan Francisco.

Juan Sanchez: Thank you, Hernan.

Carolina: And, your next question comes from Alejandro Salinas with Santander. Your line is open.

Cecelia: Hi…

Fernando Ruiz: I think you skipped Eduardo Altamirano. Okay. Sorry.

Cecelia Jimenez: Hi, this is Cecelia, actually, from Santander. My line was cut off.

Fernando Ruiz: Okay.

Cecelia Jimenez: I have a question, I have a question regarding, I have several questions, but the first one would be on building materials. The 40% EBITDA contraction year-on-year, I'd like to see if you can share with us the breakdown among the factors you said impacted division, particularly, I would like to know how much of that comes from South America, how much of that comes from the U.S. And, if you can tell us, how much of it is related to the competition, the tougher competitive environment in the U.S., or your competitors gaining market share again. So, if you can break down that EBITDA loss from the parts that actually were impacting you, that would be my first question. Thanks.

Juan Sanchez: Thank you, Cecelia. I'm glad that you can reestablish your line. So, the breakdown on the impact on the EBITDA, what I can tell you is revenues for building systems are every day larger coming from the U.S. The U.S. is taking more relevance within the division, and that is the reason that we started just in January the Indiana facility. We see growing trends in the U.S., while in the, in generally Latam, mostly in the Andean region, we are seeing contraction in the market. And, that is why we are implementing this capacity rationalization.

So, going to EBITDA, most of the impact is coming from the Andean region and that comes from both market contraction, the technology change, the kind of capacity utilization slowdown to reduce inventories that affected the fixed costs. And, also related to the right-sizing that we are doing. So, most of the impact comes from the Andean region and in general, from Latin operations.

Now, to your question on market dynamics in the U.S. As we mentioned, the, I mean, one of the other players had some issues, operational issues in 2017 and they come out from that in late '17. And, they have been fighting hard to recover those accounts. They have managed to recover some of them. We have managed to keep some of them. But, still, the winter played against both of us. What I would like to stress out also is before this chance, the customers hadn't had the chance to do business with us, and these have opened additional doors for the long run. We believe that we have proven that we can be a reliable supplier with higher customer service, and we believe that those will be the key trends to continue gaining customers and market share.

Cecelia Jimenez: Thanks, Juan Francisco. My second question would be related to the metal divisions. We have seen over the past four quarters the divisions without posting EBITDA contractions of roughly 20%, although you have improved on the pricing side and also small volume contraction. So, I would like to better understand the cost structure that you have in this division, which is actually going to be the future for 2018 in this regard. Are you expecting to have a smaller division going forward representing by metals, or are you actually planning to see some recovery in this part as well? In my opinion, it was something that, it was a very stable division, but we have actually seen material contraction over the past 12 months. So, that's my second question. Thanks.

Fernando Ruiz: Okay. Thank you, Ceci. We had a problem trying to understand your question but let me try to answer it and if we miss something, please let us know. So, the first thing you have to bear in mind is that the results that we had this division last year, the first quarter of last year was the best results that this division had in 10 years, no?. So, it was an unusual first quarter last year, no?. The exchange rate pickup of metals, it helped us a lot. So, what I can tell you today is that today our operations are practically at a full capacity. Today, maybe the, also the, the mix of products that we had on the first quarter maybe were not as good also as last year's first quarter. But, as I'm telling you, we, today we have, we're basically running at full capacity.

And, some very interesting products are doing very well. For instance, the condenser tubing, which is basically targeted for the oil and gas industry, has been improving a lot. When the oil barrel hits more than $60, $62 U.S. dollars per barrel, they start to ask for a lot of this product, which has great differentials.

So, I think what I can tell you is that this, as you say, it's a very stable division. And, during the second quarter, you will see that, no. So, I think we're on the right track, only that the comparison that we have versus last year is very unfavorable, because we had a record high first quarter last year.

Juan Sanchez: And, going a little bit deeper into that, if you remember, in the first quarter last year we mentioned that we have a benefit because changes or fluctuation in copper and FX rate both align and give us some benefits in the inventory valuation. This year, that doesn't happen.

Cecelia Jimenez: Thanks, Juan and Fernando. Finally, if I may, regarding pricing strategy in Mexico, do you think it's feasible to reach 4% price increase this year, 4 to 5% price increase? Or, do you see that as a

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risk considering the more competitive environment in cement in Mexico? That will be my third question. Thanks.

Juan Sanchez: Sure, Ceci. I mean, we believe that the second half of the year will be tougher, or it is cloudier, to put it in the right way. So, we believe that it is easier to think on a second price increase on the year in this second quarter than to think about that in the second half. Now, it is important also to highlight that we, I mean, given that we have low market share in Mexico, we do not set the prices. As we mentioned, we follow, and we are happy to follow, but we don't have the chunk yet to set prices.

Fernando Ruiz: And, just to expand on that, Ceci, and I'm sure you're aware of that, I mean, the market dynamics today in Mexico, what we're seeing, it's, I mean, the private building industry has gone great, I mean, for the last years. But, today, we're seeing that they are a bit nervous about the elections, about the NAFTA. So, I don't think, I mean, consumption might, might stay, but personally, I don't think it will grow in the second semester as Juan Francisco is saying.

So, having said that, I agree with Juan Francisco with the pricing. I don't see, I don't see an increase in price in the second semester.

Juan Sanchez: And, this pretty much in line with the statistics in an election year.

Cecelia Jimenez: Thank you. That's very helpful. Thanks.

Carolina: And, your next question comes from Eduardo Altamirano with HSBC. Your line is open.

Eduardo Altamirano: Thank you. Thank you, gentlemen, for taking my question. I just want to make sure that I understand correctly when you said that you were looking at recovering growth in Q3, maybe in the second half of this year. And, that you're taking a look at which businesses are core/non-core fit. Would that mean that you would engage in any sort of transactions where you might get out of certain verticals, you get, you divest of any certain non-core components of your business? Just, if you could provide some more color to understand what you're looking at.

Juan Sanchez: Sure. I mean, so far, we've been let's say growing through M&A strongly, and our growth or historical growth has been, or has come from both organic and inorganic growth. What we are doing now is analyzing which of these businesses are aligned to this growing strategy and aligned to the light-weight building systems strategy that we are following. And, therefore, it might come in some divestment. So far, I mean, at this point, we cannot, of course, give you more color on that, but what I would like to stress is we are analyzing business-by-business, country-by-country, location-by-location.

Fernando Ruiz: What is important to highlight is we are targeted in the traditional building systems, which is cement, and in the light-weight building systems, which is the term that we are giving to the building system division.

Eduardo Altamirano: Perfect. Thank you. You read my mind. I appreciate that.

Juan Sanchez: Sure.

Fernando Ruiz: Thank you.

Carolina: And, as a reminder, it is star and one to ask a question.

And, there are no further questions at this time. I would like to turn the program back to Mr. Ruiz Jacques for any closing remarks.

Fernando Ruiz: Thank you, thank you, Operator. And, I apologize again for the inconvenience caused by the technology and thank you all for your continued interest in Elementia. So, our team remains available for any further questions you might have. And, have a nice rest of the day. Thank you very much.

Juan Sanchez: Thank you.

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