ELEMENTIA 3Q20 Conference Call Transcript
October 29, 2020 @ 9:00am CT

Operator: Good morning. My name is Leo and I will be your conference operator at this time. I would like to welcome everyone to Elementia's third quarter 2020 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 speaker's opening remarks and instructions will be given at that time. Thank you.

I will now turn the call over to Iris Fernandez, Elementia's Head of Treasury and Investor Relations. Please go ahead.

Iris Fernandez: Good morning and welcome to Elementia's third quarter 2020 earnings conference call. Joining us today is Chief Executive Officer, Jaime Rocha, and Chief Financial Officer, Maria de Lourdes Barajas. Please be advised that this call is for investors and analysts only. During this call, they will be discussing Elementia's performance as per the press release issued yesterday which is available on the company's Investor Relations website.

All figures discussed today are unaudited and in Mexican pesos unless otherwise stated. All comparisons are related to the corresponding period of last year. Let me remind you that forward-looking statements may be made during the conference call. This are based on information that is currently available and is subject to change due to a variety of factors. For a detailed and complete disclaimer, please refer to the earnings release.

With that, I'll turn the call to Jaime.

Jaime Rocha: Thank you, Iris. Good morning and thank you for joining us today.

I will begin with a review of our operating results for the three business divisions and the strategic initiatives that have helped us achieve them. I will then ask our CFO, Maria de Lourdes Barajas to go over the details on the financial results, after which we will be happy to take your questions.

First, I want to congratulate our new CFO, Maria de Lourdes Barajas on her appointment. Lourdes is not only a career finance professional, but a career cement finance professional. She has worked at Fortaleza for 7 years as Controller and then Head of Finance, and prior to that at LaFarge in various corporate finance positions. Her experience will be a relevant part in helping Elementia reach its ambitions in terms of a profitable and thriving multi-national building materials company.

Turning now to our operating results, I am pleased with Elementia's performance for the third quarter. Despite a challenging environment, we posted strong results.

On the revenue, where the strategic initiatives begin to pay off, capitalizing our strong commercial and distribution networks, while focusing on the customer, in the third quarter, we posted a 15% consolidated revenue growth year over year reaching 7.7 billion pesos. This was driven largely by the growth in the Cement Division as a whole, growth of 31% year over year.

Cement Mexico reported an outstanding revenue growth of 40% in third quarter 2020 vs 2019. driven by 15% higher volume and improved pricing. We managed to capitalize on the resiliency of the self-construction segment during the pandemic, combined with the contribution from public sector related projects. I am very proud that last month we inaugurated the newest plant in the Elementia cement system - Progreso Plant on the Yucatan Peninsula. We invested 25 million dollars in the latest and state of the art equipment surpassing all environmental standards. It began operations with a capacity of 250 thousand tons and will be used to serve the Southern Mexico market.

Turning to Cement U.S. –we registered a 24% revenue growth over the same quarter of last year on the back of a 4% volume growth due to recovering demand combined with a better average price. This month marks the 4-year anniversary of the acquisition of a majority stake in Giant which marked our entry to the U.S. cement market. These results demonstrate the important turnaround we have made on this operation and make us confident we can reap the benefits from offering a high-quality product in the markets we serve.

Cement Central America had a challenging quarter due to the greater consumption restrictions derived from the pandemic. However, despite a 9% contraction in volume, revenue grew 2%.

On the Metals Division, revenues for the third quarter were 1.8 billion pesos, down 4% from the previous year. This resulted from an 18% fall in volume, which was partially offset by a 16% increase in copper prices. We have seen a sequential improvement stemming from the gradual recovery of the demand, the good performance of the new management team, and the continuous cost and inventory reduction resulting in a great 55% increase in the quarter versus last year.

On the Building Systems Division, the top line in the U.S. was 14% higher compared to 3Q19 reaching 1.1 billion pesos, due to a 1% volume growth and a focus on higher value products. I am very pleased with what new management of Cement and Building Systems US has been doing to lead Allura brand and this entire portfolio on the right track.

Building Systems LatAm had an excellent quarter with 19% revenue growth reaching 1.2 billion pesos, driven by a 5% volume growth and an improved price mix. Notably in this region, all the countries in which we operate have gradually removed mobility restrictions and reopened. Additionally to the improvement of sales, costs and spend in the LatAm business, we started implementing synergies to provide customers with high-quality systems for all types of water solution needs.

LatAm's team has embodied what I mean when I state that we must have in power local management teams, improving the fiber cement business in LatAm.

Consolidated EBITDA reached 1.2 billion pesos in the third quarter 2020, an increase of 24% versus last year, the highest level achieved over the last two years. The breakdown of EBITDA contribution for the third quarter by division was as follows:

- Cement Mexico with a 25% increase reaching 663 million pesos
- Cement U.S. with the highest growth of 58% reaching 316 million pesos
- Cement Central America with 15% EBITDA growth at 31 million pesos
- Metals posting an increase of 55% to 115 million pesos
- Building Systems LatAm up 51% at 184 million pesos
- Building Systems U.S. was the only division with an EBITDA contraction due to non-recurring expenses and restructuring costs required to reformulate products and redefine its markets coverage.

Let me conclude with some comments on how we expect to close the year. In every division, the main focus will continue to be: first strong cash generation, second, focus on profitability through sales, third, increase operational efficiency. There will be some impact from seasonality, but we expect the momentum from EBITDA generation will continue, which will help us end the year on a strong note.

- In Cement Mexico, the new plant in Merida will begin to contribute to our results.
- Cement in the U.S. will keep momentum but aligned to the weather seasonality.
- Cement in Central America will keep on track due to re-openings.
- Metals will continue its sequential improvement.
- Building Systems U.S. will continue to see an improvement with the optimized operations.
- And Building Systems LatAm will further expand its top line growth through sales, capacity utilization and strategic partnerships.

That concludes my remarks and I will now turn it over to Lourdes for the financial results.

Maria de Lourdes Barajas: Thank you, Jaime and welcome, Iris.

Iris is part of our new management team and was named Elementia's Corporate Treasurer in charge of the investor relations area as well. She has over 15 years' experience in finance and I am certain that her experience and capabilities will be vital during these highly challenging times.

I'm pleased to report that in the third quarter we reported outstanding results, with the highest level of EBITDA in the last two years, all thanks to the positive contributions of Elementia's three business units.

Many factors contributed to achieve this result, namely the resilience of the Cement business and several actions taken to maximize the value of the Metals and Building Systems Divisions such as:

- First, taking advantage of market opportunities to generate higher sales
- Second, rationalizing costs and expenses
- Third, focus on profitability
- Fourth, Focusing on cash flow generation, and
- Fifth, a strong discipline in working capital management

We are focused on generating greater value and remaining prudent with our financial situation in order to maintain solid EBITDA levels from now on.

With regard to the results for the third quarter, I will go over the most relevant consolidated figures: The total revenue for the company in 3Q20 was Ps. 7.6 billion pesos: Ps. 1,000 million pesos, or 15% more than the Ps. 6.6 billion reported in 3Q19. This increase was driven by higher consolidated sales volume with the cement and building systems business in Central America and the Andean region contributing the most.

In 3Q20, building system sales represented 16% of the company's total sales, compared to 11% in 3Q19. This indicates a gradual recovery in the Central and South American markets following the impacts of the pandemic felt in the previous months, as well as the implementation of the commercial strategy that puts greater emphasis on higher-value-added products to take advantage of our commercial network synergies.

The cost of goods sold during the third quarter was 5.7 billion pesos, 11.3% above 3Q19. This increase was mainly due to the depreciation of the peso against the dollar by more than 20%.

Elementia's gross profit for 3Q20 was 27% higher than in 3Q19; our gross margin was 26% in 3Q20 compared to 23% in 3Q19 and 20% in 2Q20. This was the result of higher prices and lower consolidated production costs.

The total expenses in 3Q20 reached Ps. 1.2 billion, Ps. 184 million more than the Ps. 1.08 billion reported in 3Q19. Total expenses as a percentage of revenue was 16.5% in 3Q20 and 16.2% in 3Q19. The increase was due to a combination of the currency depreciation and lower additional non-recurring expenses.

The operating income was Ps. 705 million, 50% higher than in 3Q19, which represents an operating margin of 9% for 3Q20, higher than what we recorded for 3Q19 and also above 2Q20 levels. The improvement in our operating line is mainly attributed to the combination of better volumes and pricing as well as a strong discipline regarding cost and expense controls in all of our business units. In 3Q20, the Company reported net financing expenses of Ps. 248 million, 31% lower than in 3Q19 which was Ps. 359 million pesos. This reduction was mainly due to the strategy of deferring interest and capital payments which we implemented in the second quarter.

Taxes in 3Q20 reached Ps.141 million pesos, which was 40% above what we paid in 3Q19. This was mainly due to the increase in consolidated operating income and the effect of capitalizations in fixed assets. In September, we capitalized close to Ps. 450 million pesos for the new plant in Yucatan.

In 3Q20 the Company registered a consolidated net income of Ps. 316 million pesos which was a sharp increase over the Ps. 8 million pesos recorded for 3Q19 and the net loss of Ps. 195 million pesos reported in 2Q20. This improvement was due to the better consolidated operating results achieved.

EBITDA for 3Q20 was Ps. 1.2 billion pesos, for a margin of 16%, compared to EBITDA of Ps. 1 billion and a margin of 15% in 3Q19.

In terms of our balance sheet, current assets rose 21% due mainly to the high cash flow generation reported versus December 2019.

In the first nine months of 2020, we generated over Ps. 2 billion pesos in cash largely by optimizing working capital, optimizing inventories mainly in Metals and Building Systems U.S., efficiencies in operating costs and expenses, the negotiation of grace periods for capital and interest payments with our creditors, and new financing mainly in South America.

As of September 2020, cash before investment activities represented 42% of EBITDA vs 17% in the same period of 2019. This has shown our ability to deliver our mandate of maintaining financial discipline and generating the highest level of cash flow possible, without putting our business operation at risk.

Moving on to the topic of debt, we closed 3Q20 with a total debt of US$817 million dollars, of which 13% is short term and 87% is long term. Our leverage ratio, considering the last twelve month-

EBITDA was 4.41x, it means .42x improvement when compared to the previous quarter. Our interest coverage ratio was 2.58x.

Lastly, it is important to point out that on our balance sheet we have an impact from exchange rate fluctuations in various accounts such as other accounts receivable, plant, property and equipment, intangible assets, long-term debt and other long-term liabilities.

Before I conclude my remarks, I want to emphasize that the results for the third quarter demonstrate the deployment of the new management team's main objectives, and for the coming months, the financial strategy that will be carried out will be supported by strict cost and expense controls, the generation of cash flow, and the reduction of debt as key pillars; expecting to have greater visibility regarding a more stable macroeconomic outlook.

That concludes my remarks. Operator, we are ready for questions. Thank you.

Operator: We'll take our first question from Nikolaj Lippmann of Morgan Stanley. Your line is open.

Nikolaj Lippmann: Thank you very much. Good morning Jaime and team. Lourdes and Iris, congrats on your new roles and on improving numbers.

Three questions if I may. First, on the U.S. fiber cement business, can you talk about your go-to market strategy in this business, the U.S. fiber cement, roughly your capacity utilization today.

And also, if you don't mind updating us a bit on your legal liability cases? Have they been growing? Have they remained stable? So, that's on U.S. fiber cement.

On U.S. cement, you know, great to see the improvements. Can you talk about what you're doing there in terms of cost and also commercial strategies? And if you think that, you know, you're still below industry standards in terms of profitability, you know, when do you think that, you know, you will see continuous improvement towards, you know, high 20 margins at the EBITDA level?

And then, finally—sorry for these questions—do you mind updating us now on the debt between Giant and Elementia? Now that Giant is in the black, what is the outstanding amount of liability between Giant and Elementia? Thank you very much.

Jaime Rocha: Hi, Nikolaj. Can you hear me?

Nikolaj Lippmann: Loud and clear.

Jaime Rocha: Okay. So, talking about our fiber cement business in the U.S., first, maybe it's important to, okay. Going through your question, first of all, we have been very successful during the quarter on sales.

We are at about 90% capacity utilization with the plans we have open. We, as you know from the last call, we stopped operating the Indiana plant.

So, we operate three plants for serving the U.S. market. And we continue exporting from Central America and Mexico to the U.S. So, in terms of commercial strategy and capacity utilization, we're in a very good shape.

Talking about your second question that was the liability, we have already signed an agreement for the class action. This agreement for the class action resulted in a $12.5 million liability for the future. And for this, we have already been doing reserves. So, that's one of the main reasons why you are not seeing positive financial results in the U.S. so far. This settlement has been filed to the court. So, we have to wait November to get the final result for that. But we are confident that it's going to be continuing to go on the right track.

And then, you ask about Giant debt, right? With Elementia?

Nikolaj Lippmann: Yeah, Giant debt and Giant profitability, basically.

Jaime Rocha: Okay. Well, first, about Giant with Elementia debt is US$355 million that are the original debt that we had at the beginning when we acquired four years ago the business.

And the profitability of, well, the cement business in the U.S. is getting up to almost 20% where you have seen. And in terms of Allura, we expect for next year at least to get up to between 10 and 15% profitability, EBITDA margin at least.

Nikolaj Lippmann: That's great. Can you talk a little bit about some other initiatives you have taken in Giant Cement to improve that profitability, and if you think there's further to go?

When I look at industry standards for cement profitability in the United States, I mean, it's great to see the improvements. But also, one would suspect that you could have even more upside there. Can you talk a little bit about some of the initiatives both on the commercial side and the cost side that drive the increase in profitability in that business? Thanks.

Jamie Rocha: Sure, Nikolaj. If we see, you know, that we are in three markets on the East Coast, each market works differently. But what is common between the three is first that we have improved the variable cost in a very important way and not just because we have less raw material costs or energy costs also because we have been improving the performance of the plants mainly in the South in North Carolina and also in the middle - in the Pennsylvania plant.

So, in those plants we have been improving a very important matter—the variable cost and also the fixed cost. This is coming also with a much better output of the plants that bring us the possibility to be more stable than previous years with a very important approach to the market which is where we are getting back the confidence from the market and the customers.

So, that reflects the improvement in terms of sales and in terms of costs.

Nikolaj Lippmann: Got it. Thanks a lot. This is helpful. Congrats on the numbers, Jaime.

Jamie Rocha: Thank you, Nikolaj.

Operator: And once again, that's *1 to ask a question. We'll move next to Jaime Nicholson of Credit Suisse. Your line is open.

Jamie Nicholson: Hi, thanks so much for the call. I was wondering if you could provide a little more color on the recent negotiations you have with your banks - the negotiation of payment waivers, and if you had any covenant waivers, and if so, what are those covenants? That's my first question.

And then, secondly, regarding your cash position and do you have any plans to pay down debt? Did you buy back any bonds in the third quarter, or have any plans to do that, or further paydown debt in any way in the upcoming quarter? Thank you.

Jaime Rocha: Thank you for the question, Jamie. I think it's a very good moment for Iris's debut...

Iris Fernandez: Hello, Jamie. Thank you for your question. So, in terms of waivers, yes, we have negotiated with banks waivers mainly for leverage and we're expecting to recover our levels in 2021.

Our current levels, in terms of interest, the current level is 2.58 times. And in terms of leverage, it's 4.41 times.

Then, your second question was about the cash position. At the end of September, it was close to US$185 million. And right now, we are trying to be prudent.

So, we are not planning in the rest of the year to pay down some debt. Have I answered your questions?

Jamie Nicholson: Yes, thanks. That was helpful. Just regarding the covenant waivers, what are your bank covenants in terms of leverage?

And then, also, you mentioned you wanted to recover your leverage ratios in 2021. What is your target leverage ratio to achieve in 2021?

Iris Fernandez: Yeah, for sure. On covenants our interest coverage is two times. Our leverage is 3.5 times.

We are planning to reach in terms of leverage 3.26 times at the end of 2021.

Jamie Nicholson: Okay, great. Thanks. And so, your covenant waiver is through the end of 2021 to get back below the 3.5 times, is that correct?

Iris Fernandez: No, we are trying to reach during the year, but I don't know exactly if it could be in the second semester.

Jamie Nicholson: Okay. But you have a waiver from your bank through what period of time? Is it through the first half of '21 or later? How much time do you have from your banks under your covenants?

Iris Fernandez: Yes, right now, 2020 we are expecting to reach our covenants in the first quarter of 2021.

Jamie Nicholson: Okay, great. Thank you so much. Thanks again for the call.

Iris Fernandez: Thank you.

Operator: We'll move next to Joao Rosado of Finantia. Your line is open.

Joao Rosado: Hi, thanks for taking my question. Can you just provide a bit more color on the sale of the cement assets in Pennsylvania? How much are you expecting to receive in cash terms? If it gets approved in the fourth quarter, when is the cash coming in? And can you please clarify exactly what will be the use of those proceeds?

Jaime Rocha: Hi, Joao. Well, we continue with the FTC process. It has been taking longer than expected because of Covid, for example, one of the reasons. But we expect to finalize the approval by the end of the year as you said.

In terms of the cash, we have sold this plant for US$150 million and the cash would get into the company first quarter in this year if it's approved by December let's say/early first quarter 2021.

Joao Rosado: And in terms of the use of proceeds for that cash? Are you going to use it to pay down debt?

Jaime Rocha: Today the objective for this cash is to deleverage the company, okay?

But also, it would depend on how we see the markets at the beginning of 2021, and our cash position at that time of which could be a growth opportunity also that we are foreseeing.

So, the main objective for us is the leverage as you said. But we have to also wait and see what's happening the following three months.

Joao Rosado: And then, just one follow-up question there. Is the waiver you got on the leverage covenants from the bank, does it affect the way you use that cash from the sale? Is there any constraint?

Jaime Rocha: Sorry, we are having some difficulty hearing you. But would you repeat your question please and I will pass it here to Iris

Joao Rosado: Yes, sure. The question is if the waiver you got from your bank regarding the leverage covenant, if that constrains the way you can use the cash from the asset sale down.

Iris Fernandez: Yes, for sure. As I already mentioned, we have negotiated with banks waivers mainly for leverage. And we're expecting to recover our levels in 2021.

I think in the first quarter, we are going to recover our levels. And then could you rephrase the second one please? I'm sorry, I'm having some problems with the call.

Joao Rosado: Ok, I just want to understand if you haven't recovered in terms of your net leverage ratio, if you are constrained on the way you use the cash from the asset sell down, i.e. if you haven't recovered, can the banks force you to pay down debt?

Iris Fernandez: No. No, we don't think that. And we are very confident about our solid financial position. So, we are not expecting this kind of scenario. So, no. We don't expect so.

Joao Rosado: Okay, perfect. Thank you.

Operator: And now we turn the call to Melanie Carpenter for our webcast questions.

Melanie Carpenter: Great, thank you. We have a question from Alan Miranda from Reed Intelligence. And he says, "Given these better results, are you planning to go on with the spinoff in the short-term?"

And then, the follow-up of, "What is your outlook for 2021?"

Maria de Lourdes: Yes. Well, about the spinoff, at first we saw an opportunity to add value to our shareholders with cement business as a pure player. But now, with outstanding results in building systems and metals, we are trying to take advantage of this diversified portfolio. So, we are going to wait for better market conditions. And then, we are going to take a decision.

Melanie Carpenter: Okay. And then, outlook for 2021 if you want to give any comment on that.

Maria de Lourdes: Well, in that timeframe, we are expecting better timing. If 2021, we have better conditions, we can put this bond in the agenda.

Melanie Carpenter: Okay. There's another question coming from Pine Bridge. Kathleen Monticello asks, "Does the deleveraging you're expecting from next year consider proceeds from the Pennsylvania asset sale?"

Jaime Rocha: I believe this question was already answered. We already answered that. As our first goal would be deleverage using Keystone as a cash-in. But also, it will depend on what we see in 2021, and the cash position we can achieve at the end of the year, and the growth opportunities we can also foresee for 2021.

Melanie Carpenter: Okay, excellent. That concludes the questions from the webcast. So, I will turn it back to Jamie Rocha for just a closing remark.

Jamie Rocha: Thank you, Melanie. Thank you all, operator and thank you all once again for your interest in Elementia.

I would like to thank again, our shareholders and creditors for supporting is throughout these challenging times. Please feel free to contact me, Lourdes or Iris if you have any questions.

And we hope that you and your family stay safe. And please have a nice rest of the day.

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