ELEMENTIA 4Q20 Conference Call Transcript
February 25, 2021 @ 9:00am CT

Operator: Good morning. My name is Nikki, and I will be your conference operator. I would like to welcome everyone to Elementia's Fourth Quarter 2020 Earnings Conference call. All lines have been placed on mute to prevent any background noise; there will be a Q&A session after the speaker's opening remarks and instructions will be given at that time.

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 Fourth Quarter 2020 Earnings Conference Call. Joining us today is Chief Executive Officer, Jaime Rocha; and Chief Financial Officer, María 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 investor relations website.

All figures discussed today are unaudited and in Mexican pesos unless otherwise specified. 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 calls; these are based on information that is currently available and subject to change due to a variety of factors. For additional and complete disclaimers, please refer to the earnings release.

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

Jamie Rocha: Thank you, Iris. Good morning, everyone and thank you for joining us today. I will give an overview of what we accomplished last year and what we expect for 2021, Lourdes will discuss our financial highlights and then, together with Iris, we will take your questions.

2020 was certainly a unique year of our lifetimes due to the global pandemic, the wave of shutdowns and economic slowdowns. However, I am pleased to report that Elementia was able to face the challenges effectively and come out of the year even stronger than before by successfully completing key strategic and operational initiatives.

These were based on the following pillars: drive sales growth by taking advantage of market opportunities, improve the deployment of all resources, increase profitability levels, and generating strong cashflows.

First and foremost, our priority since the Covid outbreak has been to protect all our staff and workers; in every country in which we operate we implemented several safety measures which helped us minimize cases and preserve workflow continuity.

Elementia was deemed an essential business in some of the countries in which we operate, and we were able to capitalize on the shift in consumer spending to a focus on home improvement and construction. We continued optimizing our product portfolio and rationalizing SKUs in each business division to improve sales. We kept strict cost and expense controls, and reduced inventory levels in all divisions, which drove outstanding margin improvements. And, in one of the most important steps to fortify the financial situation of the company, we completed a successful debt restructuring which has aligned our currency borrowings to revenue generation; and we used our solid cash levels to pay down debt.

Our strong performance in the fourth quarter demonstrates our strategy is having a positive impact and yielding results. Revenues increased 24% versus 4Q19 to 7.5 billion pesos, with the metals division achieving the highest growth, at 27% and the cement division up 23%. We turned things around at the operating level line with 372 million pesos in operating income, up 126% from last year's loss. Afterwards, EBITDA improved by 93% from 500 million pesos in 4Q19 to 965 million in 4Q20, which represents an EBITDA margin improvement of nearly 500 basis points from 8 to 13%. And we improved the bottom line by 87%.

These figures include some one-time adjustments we decided to undertake in order to start 2021 with a clean set of financial statements. Lulu will go into further detail regarding these adjustments, however if we exclude these, our performance would have been even stronger.

Let me now go over the results and outlook for each division:

Starting with Cement Mexico, where we continued to capitalize on the resiliency of the self-construction segment and essential infrastructure projects during the pandemic. This division reported outstanding revenue growth of 29% and EBITDA growth of 196% in fourth quarter 2020 vs 2019 driven by higher demand, the volume contribution from our new Progreso plant, improved pricing and strict cost and expense controls. For the full year period, net sales grew by 15% and EBITDA by 3%, sustaining the margin above 40%.

For 2021, we will remain focused on generating strong cashflows and improving our working capital. This division is ready to keep the positive momentum supported by demand levels from the geographic location of our operations, government projects and growing market share in the southern region.

Turning to Cement U.S. where we improve performance - reporting 24% revenue growth for both the quarter and full year period versus 2019. We have successfully turned around this operation to one of stable profitability thanks to operating efficiencies, our ability to take advantage of the recovery in market demand and an optimization of COGS and OPEX. This led to EBITDA growth of 25% in the fourth quarter and 72% for the year, which represented a 400-basis point increase in margin reaching 14%.

For 2021, we believe that demand levels in the U.S. will continue to gradually improve alongside the economic recovery, and we will keep emphasizing the importance of cash flow generation and strict cost and expense controls.

Cement Central America. Despite to the decline in demand, this division reported an EBITDA increase of 4% in the quarter and 11% for the full year thanks to our focus lower COGS and improving profitability.

Now let me turn to the Metals Division, which I am proud to report has turned the corner to profitability thanks to the execution of our aggressive transformational strategy. We were able to focus on higher value products and therefore revamp our pricing model with an average price increase of 28%; this resulted in 27% revenue growth in the fourth quarter and a return to operating profitability. EBITDA increased by 206% in the fourth quarter and 123% for the year.

We are confident that this positive momentum will continue during the year as copper prices continue to strengthen and demand starts improving.

In Building Systems, despite the slowdown seen in demand levels, our top line in the U.S. grew 16% in the fourth quarter and 14% in the full year. However, as I mentioned, our decision to register one-time adjustment to clean the financials once and for all caused our EBITDA to decline in both periods. We believe this was the right thing to do in order to begin 2021 with a clean slate.

Building Systems LatAm had an excellent quarter with 14% revenue growth reaching 1.2 billion pesos, driven by 9% volume growth and an improved price mix. We have been focusing on improving working capital and strengthening our go to market strategies, which helped generate 14% EBITDA growth in the quarter and a 284% increase for full year 2020.

We are optimistic for this division in 2021 as markets reopen and demand recovers. We will remain focused on profitability, optimizing our operations and generating additional synergies.

Let me conclude by summarizing what we plan to focus on in 2021 to reach our targets:

- Overall, our cement businesses will continue to drive strong cashflows, but the bigger contributions to growing our profitability will come from the metals and building systems divisions.
- In Cement Mexico, the new plant in Yucatán will help continue to drive market share in the region.
- Cement in the U.S. will recover further as economic growth strengthens.
- Cement in Central America will stabilize due to re-openings.
- Metals will continue its sequential improvement thanks to the new strategy.
- Building Systems U.S. will continue to see an improvement with the optimized operation in a promising market and clean financials.
- Building Systems LatAm will also keep the present growth path with the recovery of its economies.
- Finally, Elementia will continue its path to be stronger, more agile and profitable.

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

Maria de Lourdes Barajas: Thank you, Jaime, and good morning to you all.

I am very pleased to share with you our results for the last quarter of 2020. It was clearly an atypical, extraordinary year because of the public health emergency and macroeconomic conditions prevailing not just in Mexico but around the globe.

I am proud to report that at the close of 4Q20, having applied a solid commercial strategy and firm discipline in our operating processes, cutting general expenses in our administrative areas, improving working capital and generating a substantial amount of cash flow, we obtained extraordinary results, which enabled us to begin a deleveraging process that will significantly improve our debt levels and therefore reduce costs.

I will now comment on the results in more detail:

Total sales for the company in 4Q20 were $ 7.47 billion pesos; $ 1.42 billion above than 4Q19, a 23% increase. This growth was driven by higher consolidated sales volume.

Consolidated net sales grew 24%, where the cement units contributed, mainly Mexico and the United States, with increases of 29% and 24%, respectively. The Building Systems unit in the United States and LatAm also showed increases for 16% and 14%, respectively, compared to 4QQ19.

In the metals business, following our strategy of rationalizing SKUs to improve the profitability of the product mix, net sales rose by 27% over 4Q19. Compared to 3Q20, volume grew 8% and net sales 12%.

In 4Q20, the Building Systems unit accounted for 29% of the company's total sales, a sign that the Central and South American market is gradually recovering from the impact of the pandemic experienced during the preceding months. It also reflects the impact of our planned commercial strategy that emphasizes higher value-added products, taking advantage of synergies between the commercial networks.

In 4Q20, the cost of goods sold reached $ 5.97 billion pesos, an increase of $ 428 million, or 8%, over the 4Q19 level of $ 5.54 billion pesos. This absolute increase is attributed mainly to our decision to recognize a $ 243 million pesos one-off charge at a total level, directly impacting the cost of $ 178 million for class action in the month of December, with the aim of cleaning up the house for this concept and start with a year 2021 without extraordinary items.

Gross earnings for the Company totaled $ 1.50 billion pesos in 4Q20, 197% above 4Q19, which was $ 505 million pesos; with a gross margin of 20% in 4Q20 compared to 8% in 4Q19 and 26% in 3Q20.

Expenses for 4Q20 totaled $ 1.13 million pesos, 42% lower than in 4Q19. Thanks to the strict cost-cutting measures we put in place during 2020, general expenses in 4Q20 were even 11% below 3Q20.

As a percentage to net sales, total expenses were 15% in 4Q20, 17 percentage points less than the 4Q19.

Operating income ended the quarter at $ 372 million pesos, a 126% growth over 4Q19, and equal to an operating margin of 5% for 4Q20, 28.9 percentage points higher than in the same period of 2019. The rise in operating income is attributed mainly to a combination of higher volumes and prices with firm cost and expense control discipline in each of the businesses.

In 4Q20, the company reported net financing expense of $ 761 million pesos, a 40% increase vs. the 4Q19 figure of $ 545 million pesos. The increase was due primarily to the recognition of the premium paid in order to pay down the bond early and exchange-rate fluctuation effects.

Taxes in 4Q20 were minus $ 46 million pesos, a 108% decrease vs. 4Q19. This was chiefly due to variations in favor of the deferred tax.

Although the company reported a net loss of $ 343 million pesos in 4Q20, this is much less when compared to the same quarter of the previous year, which was $ 2.62 billion pesos and clearly shows we are on the right path to profitability.

EBITDA was $ 965 million for 4Q20; an EBITDA margin of 13% compared to $ 500 million in EBITDA and a margin of 8% in 4Q19.

On the balance sheet, current for the fourth quarter were 18% higher compared to the previous year, mainly due to higher cash flow generation.

At the close of December 2020 we were able to report an excess cash balance of $ 3 billion pesos, driven primarily by the focus on profitability, the improvement in working capital, optimization of inventories—mainly in Metals and Building Systems U.S.—and efficiencies in costs and operating expenses.

For the year 2020, cash conversion before capex was 35% of EBITDA at the end of December 2020, compared to 29% in the same period of 2019. This reflects our commitment to financial discipline and to generate as much cash flow as possible, while ensuring strong business operations.

In December, we began the roll-out of our liability restructuring plan with the key goal of deleveraging the company, and we announced the prepayment of Elementia's 2025 US$ 425 million dollar Senior notes.

At the end of the 4Q20, Elementia had total debt of $ 17.3 billion, split 66% short-term and 34% long-term.

The short-term debt includes the repurchase of the Senior Notes totaling $ 8.48 billion pesos, and the $ 1.84 billion pesos drawn by Nacobre from its revolving credit line.

Our leverage index, based on EBITDA for the last 12 months, was 3.44x, a significant 1.7x improvement compared to 1Q20, which was 5.14x. The interest coverage ratio was 2.81x up from 2.29x in 1Q20.

Finally, I'd like to mention that the balance sheet reflects the impact of exchange-rate fluctuations in various accounts, such as other accounts receivable; property, plant and equipment; intangible assets, long-term debt and other non-current assets.

Before wrapping, I just want to highlight the fourth quarter results are a clear demonstration that the foundations laid out by the new administration have resulted in specific and concrete actions. In the coming months, our financial strategy will focus on the following activities:

1. Improving and sustaining the EBITDA generation targeted for 2021; we will focus on profitability across our entire range of our products. The optimization of costs and expenses will continue in the year until we obtain a more adjusted operation.
2. Maintaining solid financial discipline, improving working capital across our businesses and generating as much cash as possible.
3. Improving the company's credit outlook and potentially obtaining an upgrade for Elementia.

And with this I conclude my remarks. Operator, we are ready for questions, thank you!

Operator: And we will open the floor for your questions. First, we will take the questions from the conference call and then the webcast questions. We will take our first question from Alejandra Obregon with Morgan Stanley.

Alejandra Obregon: Hi. Good morning, Elementia team. Thank you for taking my question--I actually have three; I will ask them one by one if I may. So, the first question is on Fiber Cement US. I just want to make sure I got the number right; you mentioned $241 million dollars of non-recurring charges during the fourth quarter, I just want to make sure I got that right. And when you talk about cleaning the house, does that mean that we will no longer see recurring charges during 2021 regarding the class action and that the Indiana plant is ready to resume operations? So, that's the first.

Jamie Rocha: Hi, Alejandra. This is Jaime. You got it right, we have reserved MXN 240 million, those are for not having any charge on the class action during 2021; even though our last payment on the class action will be at the beginning of 2022.

Alejandra Obregon: Got it. And what about the Indiana plant? Is that ready to resume operations?

Jamie Rocha: The Indiana plant is, today, shut down; we are not considering to reopen it in the short term.

Alejandra Obregon: Understood. And then my second question is in Mexico. So, I was wondering if you could provide some color on how the Merida facility is performing so far, and if you could also provide some color on what drove the margin contraction during the quarter in the Mexican cement operation. Thank you.

Jamie Rocha: Okay. The grinding station we have in Progreso, Yucatán is operating well; we already achieved the break-even point. We are growing our sales in a very booming economy in this Yucatán and the Peninsula market; we expect that this year will be the more important ramp-up of the operation, and I would say that it's working pretty well.
You mentioned something about that we had a margin contraction in the fourth quarter for cement in Mexico. That was more related with maintenance costs that we were doing to start the year 2021 with the most possible production capacity available. So, we did some maintenance in advance in order to have it ready.

Alejandra Obregon: Understood. Thank you. And then my last question, if I may: I would like to understand if there is any cement or clinker trading in your operations today, meaning if the redundancy strategy that you announced a couple of quarters ago in the US is still ongoing or maybe any other region that could see some trading at this stage? Thank you.

Jamie Rocha: As you mentioned, we do have some redundancy in clinker; we do have a terminal that operates close to our facility in South Carolina. So, in fact, as we speak, we are receiving clinker--also importing clinker in order to have this redundancy and also to take advantage of the market growth.

Alejandra Obregon: And if it's something that you can disclose, where is the clinker being imported from, and is it only to service your South Carolina segment?

Jamie Rocha: It's only concerning our South Carolina operation because we have capacity available in the other two plants; and the clinker--I believe--I'm not pretty sure this time for where it's coming from, but I would say from Turkey is the most probable, that this ship is coming from Turkey.

Alejandra Obregon: Thank you. That was very clear; that's all my questions.

Jamie Rocha: You're welcome, Alejandra.

Operator: And we will move next with Alejandro Chavelas with Credit Suisse.

Alejandro Chavelas: Hello and thanks for taking my question. Congratulations on the very quick turnaround in several businesses. My question is regarding Mexico first. I was wondering if there is something that's mentioned or something that I'm missing, because it appears that cash costs in the Mexico cement business went up from MXN 600 million to MXN 100 million from Q4 '19 to Q4 '20. Maybe you could comment a little bit on it.

And regarding your Yucatán business and the upside you have there from the Mayan Train, when would you expect to see improving demand from this project? Are you seeing it already or what is the progress there?

Jamie Rocha: I will address first the second question because I didn't get well maybe the first one. But about the Yucatán operation, we see the upside on the marketing in the Yucatán area; it's a state in which the government is doing very well the things, they are really empowering the private sector to invest there. We see also an increase in the residential construction as well as in all that has relation with infrastructure especially in the --I would say atomized locations like in the 'municipios'.

About the first question--could you please repeat the first question? Because I didn't get it really well.

Alejandro Chavelas: So, margins from last year to this year in the fourth quarter fell significantly and this is because cash costs were up significantly from MXN 600 million to MXN 1,000 million. So, a comment on that perhaps?

Jamie Rocha: It has a relation with the cost of maintenance, we did make in advance, most expenses that normally are done in the first quarter of the following year, let's say. So, that's why we have been increasing the cash cost.

Alejandro Chavelas: OK, that's great. Thank you.

Operator: Our next question from Francisco Suarez with Scotiabank.

Francisco Suarez: Thank you so much for your call. The question is a bit on a follow-up question that relates to portfolio integration. It is my understanding that FoB prices for clinker are very low; as you mentioned already, Turkey has been allowing to ship all sorts of clinkers to almost everywhere. So, my question relates with Progreso: is this an operation that, in your view, still if FoB prices of clinker, if those come up because of energy prices that are coming up, do you still see think that this operation could be profitable enough just like your Costa Rican operation, your grinding facility over there?

And secondly, also in portfolio integration, how do you see your overall business or the possibility to integrate further your different businesses in the US and with the infrastructure bills that might be pouring out into the market later this year and, of course, the residential segment that seems to be working quite well? Thank you.

Jamie Rocha: Thank you for your questions. Well, first, if you compare the operations with Yucatán operation and Costa Rican operation, they are similar, but not the same; the profitability is clearly better in Costa Rica not because of the cost structure, more related with the sales price. And in terms of the clinker cost--of course, I understand the concern and I have it also--if energy prices are going up, we could expect some movements on the clinker cost. But this means the cost is also going to be happening or increasing in Mexico. So, all these energy costs that are increasing in terms of electrical or thermical costs are going to push prices up too because it's not something that will affect imported product, it's also affecting domestic production. So, in this respect, I would expect that everything will move in some ways in parallel.

About your question related to the US, the integration of the businesses, we have been integrating the companies in terms of administration, doing many synergies, and working well together in what is more administration. In terms of operation, as both companies go to different moments of construction and different segments, I don't foresee many synergies in terms of the commercial strategy, for example, because one, is starting of the residence, for example, the grounding and so on; and the rest at Allura, that is fibercement, is going more in the final construction.

So, it is possible to have some synergies, yes, especially in the Southeast where we do have our plant in North Carolina for fibercement and South Carolina for cement, but it's not something that builders—are not even the same builders, for example. And one cement is more related to infrastructure and precast or ready-mix, and Allura goes more directly to final builders.

Francisco Suarez: That's very clear; thank you so much.

Operator: And we do have a follow-up from Francisco Suarez with Scotiabank.

Francisco Suarez: Apologies, but I wanted to give a space for other people asking questions, sorry for that. But the question that I have in Mexico again is about – you are closely linked to self-construction; I mean if I recall correctly, your overall footprint and your overall market perhaps resembles more of an exposure of roughly 60 percent or something to self-construction and that is likely to continue working very well. But you mentioned already in your press release that you are starting to see a pickup in demand from infrastructure works. So, my question relates on, one, how do you see your overall mix between infrastructure works and self-construction in the mix, and also how do you see yourselves positioned in the market to offer services to the infrastructure in general in Mexico? Thank you.

Jamie Rocha: Thank you for your question. What I see for Fortaleza, or Elementia cement in Mexico, where we see us is that self-construction will continue driving our sales and driving the market; and also, when we say infrastructure projects, we don't really see that will be really huge infrastructure projects as the three infrastructure projects that were started last year by this administration. We see more specific projects that are small or medium size related to the local governments, and it's going to be much more atomized; it's not something that we're expecting to be concentrated in one, two, or three new projects. And also, we do see that there are some 40 projects that were also announced by the government that could also support this infrastructure demand.

And where we see the Fortaleza sales along this year is in a mix that I would say it's more or less average in the industry, that is more or less 60 percent bags and 40 percent bulk, and bulk is what is going to--not just infrastructure projects, also whatever comes from formal residential, commercial, industrial.

Francisco Suarez: Got you. And as a follow-up, I guess on what you mentioned on how atomized the end market might be on infrastructure projects, I think that your overall footprint has a certain advantage. I mean it does have this connectivity with those local governments to profit out of those potential projects, isn't it?

Jamie Rocha: We do work - not directly really with the local administrations or governments - what we do is we work through our distributors' network that are the atomized, the one that has the local relation, and contact, and proximity to the opportunities that every local market has.

Francisco Suarez: Very interesting. Very clear. Thank you so much.

Operator: And there appear to be no further questions at this time. I would now like to turn the floor back over to Mr. Jaime Rocha for any closing remarks.

Jamie Rocha: Thank you, operator. Thank you all once again for your interest in Elementia. I would like to thank, again also, our shareholders and creditors for supporting us through these challenging times, allowing this management and Elementia to evolve, to be stronger, more agile, and profitable. Please, feel free to contact me, Lulu, or Iris if you have any questions.

We hope that you and your family will stay safe and have a nice rest of the day. Thank you very much for the call and for all your interesting questions.

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