ELEMENTIA 1Q21 Conference Call Transcript
April 28, 2021 @ 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 the Elementia 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. 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 First Quarter 2021 Earnings Conference Call. During this call, we will be discussing Elementia's performance as per the press release issued yesterday, which is available on the company's investor relations website. This quarter, we have added a presentation to accompany management's remarks. We hope you find this added feature useful.

All figures discussed today are unaudited and in Mexican pesos, unless otherwise stated. All comparisons are related to the last year's corresponding period.

Let me remind you that forward-looking statements might be made during this presentation; these are based on information currently available and subject to change due to a variety of factors. Please refer to our disclaimer in the presentation for guidance in these matters. Please be advised that this call is for investors and analysts only.

Joining us today are Chief Executive Officer, Jaime Rocha Font; and Chief Financial Officer, María de Lourdes Barajas. Jaime Rocha will give an overview of our performance in the first quarter, an update on the spin-off process, as well as some guidance figures; Lourdes Barajas will discuss our financial performance, and then we will gladly take your questions.

With that, I'll turn it over to Jaime.

Jaime Rocha: Thank you, Iris. Good morning, everyone, and thank you for joining the First Quarter 2021 Earnings Call. I am pleased to report that in the first three months of 2021, Elementia recorded positive results across all relevant areas. The multiple initiatives we set in motion during the last year have helped us to become stronger, more agile, and profitable. The company's balance sheet is stronger supported by the cash flow generation which helps us reduce debt levels and improve leverage. Through the payment of our senior note, we reduced our net debt to EBITDA at 3.17x; this is the lowest leverage for Elementia since 2018.

Elementia is becoming more agile through the production optimization and the commercial strategy based on value over volume; we are also seeing better market dynamics in 2021 as countries reopen thanks to vaccine development; better pricing helped us generate 17% revenue growth in the first quarter. Although energy and raw materials' prices have been increasing, we were able to offset this through our pricing initiatives, and the continuation of expenses, savings, initiatives drove to a 356-basis points reduction in SG&A.

Our profitability levels have improved as a result of rationalizing low-yielding products and improved efficiencies. By driving higher value-added products in our mix, we increased our sales volumes in all three business divisions, which led to a 405-basis-point improvement in gross profit margin compared with the same period of last year.

Operating income and EBITDA grew 337 percent and 63 percent, respectively, compared to Q1 of 2020. On the other hand, we were able to revert the net loss we registered last year to report a net income of MXN 559 million in the first quarter.

Turning to our results by business division, here we see our strategies for each unit are hitting on the right track. Starting with Cement Mexico, reported a 25 percent increase in revenue and 12 percent increase in EBITDA as a result of improved pricing and volumes; we were able to achieve these results in spite of the power shortage and extra cost experienced in February. We forecast the market will keep a positive momentum for Fortaleza products during the rest of the year.

In Cement US, a mild winter reduced, in Q1 of 2020, seasonality effects. In the regions where we operate, both sales and EBITDA grew by six percent while operating income increased by 15 percent; we believe this growth will be sustained throughout the year as demand for housing and infrastructure projects continues to rise.

In Cement Central America, we reported 18 and 15 percent growth in sales and EBITDA, respectively, thanks to strong demand and efficiency improvements in our operations. We expect to maintain a positive performance in this region.

Turning to metals, we posted the best quarterly result of the last three years for this division thanks to our decision to focus on value-added products and continue progress on improving operational efficiencies. We recorded operating income of MXN 75 million, a significant improvement versus the previous year's recorded loss. EBITDA increased by 178 percent while we will continue to capitalize on the pricing dynamics and on improving our customer base.

Moving to building systems, in the US, we maintain a strict cost and expense discipline which led to a 700-basis-point increase in operating margin; we continue to focus on profitability by optimizing our product offering and taking the initiative in pricing.

In Building Systems Lat Am, we are pleased to report the reopening of our Honduras plant; our strategy of focusing on value over volume led to improved sales, up 33 percent, and EBITDA growth of 270 percent during the quarter. We will continue to drive pricing and product optimization initiatives.

I will now give you an update on the spin-off process. As you may already be aware, we will have two separate entities: one a pure cement play, which will trade under the ticker, FORTALE, with all the cement assets; and the other, with the metals and building system assets, which will trade under the current ELEMENT ticker. We trust this is the right timing to undergo this process, even our financial situation has improved as a result of the stronger results and our delivering initiatives.

As far as our guidance for the full year of 2021, we feel confident we will continue to further improve our already solid market position for each division; we will work to improve our capacity utilization and take advantage of the stronger demand and market dynamics which will help grow our top line by around 10 percent this year. Thanks to the continuation of our efficiency initiatives and stronger pricing, we expect EBITDA to be approximately 16 percent above last year and with a 100 basis-point increase in EBITDA margin.

Let me conclude by summarizing what we plan to focus on in 2021 to reach our growth targets. In Cement Mexico, we will continue to drive pricing levels and optimizing product mix. Cement US will keep improving sales and price further as positive demand dynamics continues; Cement Central America will improve due to business reopening, trending to better capacity utilization. Metals will continue to improve its profitability level thanks to the addition of more value-added products, cost-reduction initiatives, and investment on improving our operations. Building System US will continue to see an improvement with the optimized operation and strong demand for housing products. Building System LatAm will keep growth with the reopening of the Honduras plant and the reactivation of important markets such as Panama and Nicaragua.

And lastly, we will work to complete the spin-off process to create further value for our shareholders.

That concludes my remarks. And now, I will turn it over to Lourdes to review our financial performance.

María de Lourdes Barajas: Thank you, Jaime; and good morning to you all. I am very pleased to share with you Elementia's First Quarter 2021 results and the key aspects of the period.

By continuing the commercial strategies we began in the second quarter of 2020 and maintaining strict financial discipline in our business to optimize all of these companies resources, Elementia reported a 63 percent year-over-year increase in consolidated EBITDA. Consolidated net sales in Q1 of 2021 totaled MXN 7.48 billion, 17 percent higher than in Q1 of 2020; the increase was driven mainly by higher sales volume and our price increase strategy.

Starting in 2021, all our businesses are focusing on maximizing profitability in the product portfolio and reinforcing the productive processes to guarantee their quality. With better market dynamics in 2021 and with our products better positioned in various segments, volume was up 8.2 percent in consolidated terms while the Cement and Building System businesses reported total increases of 8 percent and 9 percent, respectively. Our prices increased significantly across the entire product range, most notably in the metals business with 24 percent and in Cement and Building Systems, where they increased 7 percent overall.

The consolidated cost of goods sold decreased by 2.05 percentage points in proportion to net sales, comparing Q1 of 2021 against the same quarter of 2020; the reduction was due primarily to optimization of production processes in every business. Also, in proportion to net sales, operating expenses were 3.56 percentage points lower in Q1 of this year than in the same quarter of last year at 14.91 percent compared to 18.47 percent the year before. This was achieved mainly through a strict discipline in general expense and the administrative simplification we have maintained up until now.

Operating income was MXN 573 million, 337 percent higher than in Q1 '20, and representing an operating margin of 8 percent for Q1 '21, 5 percentage points higher than in the same period of 2020. The rise in operating income is attributable chiefly to the combination of higher volume and prices, and strict cost and expense discipline in each business.

As a result of all the initiatives implemented in the first quarter, Elementia generated MXN 1.08 billion in EBITDA, a 63 percent increase over Q1 of 2020. The EBITDA margin was 14 percent up from 10 percent in Q1 of 2020. The operations that contributed most to this result were the metals and building systems globally.

Consolidated net income closed Q1 of 2021 at MXN 559 million, a 285 percent advance over the amount reported in Q1 2020. Total financing costs contributed strongly to the company's bottom line in this quarter, and it was reduced by 146 percent from Q1 of 2020, driven primarily by foreign exchange gains and a reduction in interest expense resulting from the refinancing strategy we implemented in January of this year.

Our consolidated income tax bill was 53 percent lower than in Q1 of 2020, chiefly because of efficiency in the group's amortization of previous year tax losses against higher operating and financial income in all three business divisions. Clearly, this result reflects the success of the business strategy and financial discipline applied in all the businesses.

Moving on to the performance by business unit, starting with the cement divisions, at the close of Q1 2021, the cement business unit reported sales of MXN 2.83 billion, 16 percent higher than those of Q1 2020. The volume and average price for the three regions increased 8 percent and 7 percent respectively compared to the year earlier period.

Because of the focus on product profitability and strict cost and expense discipline, operating income was 30 percent higher than in Q1 '20, closing the quarter at MXN 332 million. EBITDA was MXN 632 million, a growth of 12 percent compared to Q1 2020. Net income for this business segment totaled 331 million, a 164 percent increase over the year earlier period.

During Q1 of 2021, the metals business reported sales of MXN 2.22 billion, 20.6 percent above Q1 2020 level. Cost margins have been modestly reduced thanks to the strategy of producing and selling more profitable products; EBITDA for the quarter was MXN 150 million, 180 percent higher than in Q1 2020.

Net income totaled MXN 43 million, more than double the amount reported in Q1 2020. The reduction in financial expenses in this business was a key factor in this result.

As regards the building system divisions, at the close of the first quarter, sales in this segment stood at MXN 2.28 billion, a 17.1 percent increase compared to Q1 of last year. The margin of cost of goods sold to sales improved by five percentage points due to the better production levels primarily, and operating expenses were also reduced by three percentage points thanks to operational optimization. Net income for the division was MXN 88 million, almost 400 more than in Q1 2020.

Speaking about the debt profile, I can share that on December 15, 2020 we made advance payment on a senior note for US$425 million plus the 1.833 percent premium established in the contract for early repayment using our cash surplus from 2020.

We took out new crediting totaling MXN 6.44 billion, and at the end of the quarter, our net debt was 14 percent lower than in 2020.

Applying the cash generated in Q1 '21, we also prepaid MXN 412 million in debt, equivalent to US$20 million. This places us in a solid financial position. At the close of Q1 2021, Elementia reported a leverage ratio of 3.17x compared to 3.44x at the end of last year, an improvement of 0.27x. The interest coverage ratio was 3.30x.

To briefly summarize, the main benefits of our refinancing strategy were a reduction in the company's leverage from 5.14x at the close of Q1 2020 to 3.70x; gross debt was reduced by MXN 2.44 billion, more than MXN 100 million a year in financial cost savings with a positive carry of 74 basis points. We reduced our exposure to exchange rate fluctuations, and we aligned our debt structure with the company's EBITDA generation.

Finally, on our balance sheet, current assets closed Q1 of this year 12 percent lower than one year before, primarily because we used our cash surplus to pay down debt. The breakdown of the company's liabilities shows a reclassification of short and long-term debt with repayment of the senior note in January, improving our debt maturity profile. We reduced our total depth by MXN 2.44 billion and our total liabilities by 10 percent.

At the close of Q1 of 2021, cash flow before capital expenditures was equivalent to 19 percent of EBITDA, when it was negative in the same period of 2020. The improvement is due primarily to better results and the application of tax loss carryovers that enable us to reduce our tax payments by 25 percent. In 2021, we will continue our strategy of maximizing cash flow and will apply capital expenditures according to the financial result of our businesses.

Before wrapping up my comments, I would like to comment that Q1 results are a clear demonstration of the sustainability of the commercial operating and financial strategy in place since the second half of last year; in coming months, our financial strategy will focus on the following activities: improving and sustaining the EBITDA generation targeted for 2021; we will do this through a focus on quality and profitability in all our businesses; maintaining solid financial discipline, improving working capital in all our businesses; executing the planned spinoff in the third quarter of the year, financially strengthening each segment; improving the outlook for the companies, both the spin-off and parent companies; and potentially seeking a credit upgrade for both of them.

With this, I conclude my remarks. Operator, we are ready for questions. Thank you.

Operator: [Operator Instructions] We'll take a question from Nikolaj Lippmann of Morgan Stanley. Your line is open.

Nikolaj Lippmann: Hi. Good morning. Just three questions and thanks for taking my questions here. First, could you address your sort of revenue volume in Mexico which were extraordinary on the revenue side and less so on the cost side; how are you sourcing your cement for the grinder in Mérida. So, that's one. And two is on the US; it's clear that the US is improving, but when we think about future profitability improvement, should we mainly look at revenue or do you think you have more to do on the cost side?

And then, finally, Jaime, if you don't mind trying to address how you're thinking about participating in M&A in North and South America vis-a-vis doing greenfield?

Jaime Rocha: Hi, Nikolaj. Great to see you again. We'll get into the questions one by one. First one, Mexico revenues are mainly driven by our pricing initiatives, we have been improving pricing all along the operations; and according to last month's results, we are almost on capacity in our grinding station in Yucatan, taking advantage of a very booming market that we have in the Southeast, good pricing levels, and also a good cost structure.

In the US, the improvement we have for better revenue is coming also from cost; the margins are coming mainly from variable cost reductions; pricing is on a process of increasing the prices during April and May, that is what's been happening in the US after the winter season; and also, what is improving, also the revenue side, is the good performance at our Keystone plant, the plant we have in Pennsylvania have been improving sales, volumes, and prices all around this quarter.

And about M&A, we are analyzing different M&As and even organic growth along the regions where we operate from the US to the South American markets, as well as in cement, also in building systems.

So, I don't know if this is answering your question, Nikolaj.

Nikolaj Lipman: Thank you and maybe on the US side, do you feel that you have more to do in terms of the cost base there?

Jaime Rocha: I believe that we do have some, let's say, warnings on fuels, especially on petrol. We have just one plant operating on petrol, that's the one that is located in the north, in Maine; but by other side, we are improving our alternative fuels business in the south, also getting more alternative fuels in the Pennsylvania plant, so this will, in some way balance, whatever warning we can have with the petrol cost that is about double than last year.

I don't think that we can go any further down in variable cost, but we're still in the process of optimizing fixed costs, maintenance costs, and also volumes, that we know that, in the states, are the main relevant cost, and with better sales volumes, we can improve that also further.

Nikolaj Lipman: Thank you very much.

Operator: [Operator Instructions] And it appears that we have no further questions at this time. I'd be happy to return the call to our host for any concluding remarks.

Jaime Rocha: Well, I want to thank you all for being in our call and for your interest in Elementia; as we continue to navigate into '21, we will focus on what we can control such as the safety of our team, the optimization of our product portfolio, and stronger pricing strategies to take advantage of opportunities as countries begin opening and mobilizing more and more.

We will continue the successful initiatives that will make the company stronger, more agile, and profitable in order to add value to all our stakeholders. Please, do not hesitate to contact Iris if you have any additional questions or comments, and we look forward to seeing you in the next call. Thank you very much.

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