ELEMENTIA 2Q21 Conference Call Transcript
July 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 Second 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 second 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 us.

I am pleased to report one of Elementia’s strongest quarters in which we continue to register results that surpassed pre-pandemic levels. From the top line to the operating line and through to EBITDA, our strategy to capitalize on demand recovery across markets and optimize pricing capabilities, helped us to offset rising raw material and energy costs and still reach higher profitability. Elementia is now more agile thanks to our focus on the products quality, the customers and on value over volume.

Let me take you through some key highlights for the period.

For starters, we are very close to completing the previously announced spinoff process. We expect to announce the completion over the coming weeks and we will begin reporting earnings results for the each of the two independent entities by next quarter.

In relation to our debt, we reduced the total amount by 250 million pesos in April, in line with our objective to improve the leverage ratio.

For the second quarter results, Elementia reported revenues of 8.4 billion pesos, up 29% compared to the previous year and up 13% versus the previous quarter, supported by sequential recovery in demand and pricing.

We managed to implement price increases across most business lines which helped us offset rising input costs, while also reducing operating expenses by 900 basis points. This led to an increase of 810 basis points in gross margin. Operating income rose by more than a thousand percent and EBITDA grew by 128 percent compared to 2Q20. This resulted in a reversal vs. last year's net loss to a net income of 65 million pesos this quarter. Net income would have been higher, but was affected by a one-off non cash item related to the notification we received by the FTC last May of their decision against the sale of Keystone. We have terminated the agreement and are reintroducing this operation back into our results. Maria de Lourdes will go over the non-cash effects that affected net profit in more detail later in the presentation.

On the next slide we present the significant improvement Elementia has made on its profitability levels, as shown by the growth in EBITDA from 934 million pesos before the pandemic in 2Q19 to 1.6 billion pesos this quarter, with an EBITDA margin of 19%.

On the next slide, you can see the breakdown of the main factors that contributed to our EBITDA generation. Through our efforts across all markets to drive sales growth and our ability to implement price increases, while maintaining a strict control over costs and expenses, we were able to deliver record EBITDA levels.

I will now go over the highlights for each division and region, beginning with Cement. This division is experiencing tailwinds from the strong growth in construction across our regions. Thanks to the planned investments made in maintenance, which we continued even during the pandemic, Elementia's cement production facilities have been operating efficiently at maximum capacity to benefit from the positive demand trends.

In Cement Mexico, we registered 1.7 billion pesos in net sales for the second quarter of 2021, up 32% versus last year, and 9% above the previous quarter, driven by a higher mix of bagged cement sales. EBITDA for Cement Mexico reached 693 million pesos, up 29% versus last year thanks to improved pricing and cost efficiencies.

In Cement US, net sales for the second quarter reached 1.6 billion pesos, with EBITDA up 13% versus last year to 233 million pesos, as a result of the market's tailwinds and cost efficiencies resulting from higher capacity utilization in all our plants.

In Cement Central America, revenues grew 18% year over year to 134 million pesos in the second quarter, while EBITDA increased 24% to 42 million pesos. We are experiencing stronger demand , while achieving important savings through operating efficiencies to drive profitable growth.

Turning to Metals, we reported 2.6 billion pesos in revenues for an increase of 51% year over year. EBITDA grew by 295% to 217 million pesos, as a result of an improved product mix favoring value added products combined with cost and expense discipline.

Moving to Building Systems, in the U.S. with the focus we have set on quality and service, we have continued to achieve stronger volumes and improved pricing, which led to 12% growth in revenues reaching 1.5 billion.

We were able to offset rising input costs and continued with our cost and expense discipline, which led to a turnaround in operating performance and profitability. We went from an operating loss last year to operating income of 61 million, an increase of 166%. EBITDA also went from a loss to positive 107 million, up nearly 700% year over year, with EBITDA margin of 9% which is the start of the expected improvement.

In Building Systems LatAm, we have successfully returned this operation back to a higher standard supported by the market recovery. Revenues were up 68% versus last year to 1.2 billion pesos. We reverted last year's operating loss to an operating income of 144 million pesos, up 190%, with EBITDA up 400% to 214 million pesos. The EBITDA margin for the Building Systems Latam operation increased almost by 3,000 basis points to 18% versus a negative 10% last year and positive 12% in the same quarter of 2019.

As far as our guidance for the full year 2021, we feel confident we can continue improving our market position for each business in every country; we will continue to capitalize on the stronger demand and better market dynamics to deliver double digit increases in both Revenue and EBITDA. And we expect our EBITDA margin to improve by 500 basis points when compared to 2020 levels. We have a proven, stronger and optimized product portfolio. We will continue to focus on improving prices, with the operating discipline to optimize costs and expenses in order to achieve higher profitability levels.

Let me conclude by summarizing what we plan to focus during the 2nd half in order to reach our growth targets.

In Cement Mexico, we will continue to debottleneck and optimize operations while increasing pricing as a result of an improved product mix.

Cement US will keep improving sales and pricing as positive demand dynamics continue.

Cement Central America will improve following the market recovery and cost efficiencies.

Metals will continue to take advantage of the demand recovery with added value products and cost efficiencies.

Building Systems US will continue to see an improvement driven by better pricing and higher efficiencies at fully utilized operations.

Building Systems LatAm will continue to take advantage of its turnaround momentum.

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 María de 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 results for the second quarter of 2021, and the key aspects of the period.

This clearly was an outstanding quarter, not just after the first year of the pandemic, but even compared to the results of 2019. This proves that Elementia is well aligned behind a strategy of making our clients our highest priority while maintaining strict financial discipline and optimizing the use of financial resources in each business.

Following this approach, Elementa reported EBITDA of $ 1.57 billion pesos in 2Q 2021 and a margin of 19%, 128% higher than the margin reported in 2Q 2020, and even 68% higher than the margin reported in the second quarter of 2019.

Consolidated net sales in the second quarter of 2021 totaled $ 8.41 billion pesos, 29% higher than in the second quarter of 2020. The increase was driven mainly by higher demand for our products and better prices.

The consolidated cost of goods sold decreased by 1.15 percentage points in proportion to net sales, comparing the second quarter of 2021 against the same quarter of 2020, from 80.0% to 78.9%. The reduction was due primarily to our improved use and optimization of production processes in every business, which offset the rise in the price of our main inputs, which are commodities.

In absolute terms operating expenses declined by 9% compared to 2Q 2020. In proportion to net sales, they were 5.62 percentage points lower in the second quarter of this year than in the same quarter of last year, decreasing from 19.02% to 13.4%, mainly because of strict discipline in general expenses and the administrative simplification we applied not just in corporate headquarters but in the management structure of each country.

Operating income totaled $ 640 million pesos, significantly higher than in 2Q 20, bringing the operating margin to 8% in the second quarter, 6.7 percentage points higher than in the same period of 2020. This increase in the operating margin is attributable primarily to the combination of higher volume and prices with a strong cost and expense discipline in each of the businesses.

As a result of all the initiatives implemented in the second quarter, together with the strong commercial strategy and sound financial discipline in terms of costs and expenses, Elementia reported $ 1.57 billion pesos in EBITDA at the close of 2Q 2021, a 128% increase over the second quarter of 2020.

This is the highest quarterly figure in the last 7 years of Elementia's history.

The EBITDA margin was 19%, up from 11% in 2Q 2020, higher even than the 14% reported in 1Q 2021.

Consolidated net income closed the second quarter of 2021 at $ 65 million pesos, a 133% advance over the amount reported in 2Q 2020.

I should mention that in June, following the cancellation of the Keystone sale, these assets were reclassified from assets available for sale to fixed assets, and the depreciation was entered under cost of goods sold, as established in the accounting rules. The recognized effect totaled $ 340 million pesos, which had a direct impact on net earnings for the quarter.

Net earnings in the first half of the year came to $ 624 million pesos, 226% above the level reported at the end of the second quarter of 2020, and around nine times higher than the 2Q 2019 figure.

Total financing cost rose in 2Q 2021, reaching $ 503 million pesos, compared to $ 218 million in the same period of last year.

Despite lower interest expense and banking fees, this line was pushed higher primarily by exchange-rate volatility and the valuation of derivative instruments.

Our consolidated income tax bill was 106% higher than in the second quarter of 2020, chiefly because of 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.

Regarding results by business unit, about Cement, at the close of 2Q 2021, the Cement business unit reported sales of $ 3.38 billion pesos, 16% higher than those of 2Q 2020. Sales volume for the three regions increased 17.8% compared to 2Q 2020.

On an extraordinary basis, and following the non-approval of the FTC of our sale of the Keystone plant in Pennsylvania, we reincorporated these operations into our results, recognizing an operating depreciation of $ 340 million pesos, which resulted in an operating loss in the United States in the month of June only, totaling $ 310 million pesos.

EBITDA was $ 968 million pesos, a growth of 24.1% compared to 2Q 2020. Net income for this business segment totaled $ -73 million pesos, an atypical result attributed to the aforementioned reincorporation of the Keystone plant.

About metals, during the second quarter of 2021, the Metals business reported sales of $ 2.56 billion pesos, 51% above the 2Q 2020 level.

Cost margins improved by 4 percentage points due to a more profitable product mix and strong cost and expense discipline.

EBITDA for the quarter was $ 217 million pesos, 292% higher than in the same quarter of last year.

Net income totaled $ 73 million pesos, a considerable improvement over the $ -24 million peso loss reported in 2Q 2020. Higher volumes and better prices made a strong contribution to this result.

About building systems, at the close of the second quarter, sales in this segment stood at $ 2.33 billion pesos, a 34% increase compared to the second quarter of last year.

The margin of COGS to sales improved by 17.7 percentage points due to better production levels, primarily, and operating expenses were also reduced by 5.7 percentage points thanks to operational optimization.

Net income for the division was $ 180 million pesos, a 158% growth compared to 2Q 20.

At the close of 2Q 2021, our total debt was $ 14.28 billion pesos, a reduction of $ 3.11 billion, due primarily to the advance payment we made on the Senior note in January, and a prepayment of $ 250 million pesos in debt in the month of April.

This places us in a solid financial position: at the close of 2Q 2021 Elementia reported a leverage ratio of 2.42x, compared to 4.83x in the same period of last year, an improvement of 2.41x.

The leverage ratio reported in 1Q 2021 was 3.17x, so this quarter even shows a sequential improvement of 0.75x.

The interest coverage ratio for 2Q 2021 was 4.06x, well within the limits established in the financial covenants we have with our creditors.

The refinancing strategy we applied in the first half of the year mitigated our exchange-rate risk. Currently, 22% of our debt is at fixed rates and 65% of it is long term.

On our balance sheet, current assets closed the first half of this year 10% lower than their levels one year earlier, primarily because we used our cash surplus to pay down debt.

Regarding the company's liabilities, we are reporting an 18% reduction, primarily because of our repayment of the Senior Note in January.

At the close of the first half of 2021, cash flow before capital expenditures totaled $ 1.16 billion pesos, equivalent to 44% of EBITDA. Cash flow was consumed primarily by increased working capital investment and a rise in interest payments after the financial structuring of 2020.

During 2021 working capital investments were $ 297 million and were focused on improving and optimization of our business's operating processes.

In 2021 we will continue our strategy of maximizing cash flow and will apply capex based on the financial results of our businesses.

Before wrapping up my comments, I'd like to comment that the results for the first half of this year 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, having financially strengthened each company.

Improving the outlook for the companies—both the spinoff and parent companies—and potentially seeking a credit upgrade for both.

With this, I conclude my remarks. I will ask the operator to open the floor for your questions. Operator, please.

Operator: Thank you. At this time if you would like to ask a question please press *1 on your phone at this time. Again, that is *1 on your phone. We'll take a question from Nikkolaj Lippmann of Morgan Stanley. Your line is open.

Nikkolaj Lippmann: Thank you. Hi, Iris, Jaime and Lourdes. Congratulations on these strong results and the turnaround, and thanks for taking my questions. A couple of questions here. First, on the Keystone plant, I'm sorry if I missed it here but is there any chance you're going to put that back on the market and try to sell it? If you're keeping it, how should we think about CapEx and the competitive position of that plant? So that's question number one.

Number two, if you can elaborate a bit perhaps on the exchange loss or the cost of the quarter? It just seems, there's very little volatility in the FX market and the currencies that we would typically think about so if you can give any color on what's sort of going on there?

And then finally, for Lourdes, and again, sorry if I missed it, when I look at the balance sheet here and I see that reduction in goodwill and the minority interest is that basically the reincorporation of badwill from the Keystone plant or how should I think about that? Thank you.

Jaime Rocha: OK, Nikkolaj. Good morning and thank you for your questions. Taking the first about Keystone, we have always kept Keystone. We have worked with Keystone as every day even during the sales process. We are focusing our efforts to keep this plant as best as possible as if we would not be selling it. So for us to keep Keystone is the natural way to continue and continue to take advantage of all the improvements that we have seen at the plant, at the market, and mostly in the results for the plant. So the plant is today at the average of Giant Cement profitability and that was not the case before. So we see that keeping Keystone is the best way to continue with the operations in the United States.

About the FX volatility, our debt is balanced on what is pesos and dollars, debt and income, so it's something that we did in the last restructuring. So this will be, let's say, balanced in whatever FX is happening. And in Mexico, we see stable the FX. And in LatAm maybe we have seen some movements, minor movements, not dramatic ones especially in Costa Rica and Colombia and we have seen also some positive FX like in, for competition like for example in Bolivia in which we have the Real in Brazil that has appreciation that helps the business in Bolivia to improve their sales with less imports from Brazil. So FX have had a positive and negative impacts but all, in my opinion, have been not really material, but marginal effects.

And I don't know Lourdes if you can take the next question?

Maria de Lourdes Barajas: Yes. Well, at the time the Keystone sale was decided, the financial condition of the plant was different from what we have now. At the end of June, well because on the financial statements, we only will make an adjustment to revert the account from assets available for sale to fixed assets. And due to the IFRS-5, the accounting rule, we won't recognize the depreciation in the Cost of Goods Sold around three hundred forty million pesos.

Nikkolaj Lippmann: Got it. Okay. Thank you.

Operator: And once again, to ask a question you may press *1 on your touchtone phone. You can also ask questions through the webcast portal by clicking on the question mark icon and typing in your question and hitting send. We'll go next to Diego Arredondo of GBM. Your line is open.

Diego Arredondo: Thank you, thank you for taking my question, Jaime and Maria, congratulations on the results. I have two brief questions. My first one would be thinking about an infrastructure plan in the U.S. in the following years, how do you feel in terms of your actual operations and should we thinking of some kind of expansion in the U.S.? And my second question would be what are your thoughts in terms of capital allocation in Mexico bearing that your domestic capacity is practically peaked as you were mentioning? Those would be my questions. Thank you.

Jaime Rocha: Thank you for your questions. About the first one, we feel that we are still well positioned for growth in the U.S. not just because we have some spare capacity still in the Northern plants, also because we have been starting since I would say 2018 to import in the United States. So we have been using imports as a buffer to keep and take advantage of all this growth in the markets where we operate and we continue to seek for different projects related to use our installations in a better way, debottleneck operations and keep the increase in the demand.

About capital allocation in Mexico, we started a project to debottleneck one of our plants in Mexico, in which we will increase our capacity for next year, in the middle of next year and about 10% of our total capacity in Mexico so that will give us the possibility to keep any market demand increase. And the last one was, sorry?

Diego Arrendondo: It was just those two. Thank you very much.

Operator: And once again, that's *1 over the telephones and again, through the webcast portal please click the question mark icon and type your question, and then select send. One moment while we cue.

We have a follow-up from Nikkolaj Lippmann, Morgan Stanley. Your line is open.

Nikkolaj Lippmann: Thank you. And sorry, I don't mean to monopolize the questioning here. Two questions. Jaime can you remind us about your import capacity in the United States, one and two as your balance sheet improves are you thinking that it might be a good investment to increase the use of working capital in the different markets that you operate and if you do think that can you expand on the kind of businesses that you operate? Is it primarily in fibercement or is it also something that you think is appropriate in the cement business? Thanks.

Jaime Rocha: Okay. About the first one, import capacity is something it's more flexible, it's not limited capacity on importing because you can change the format in which you import. So one part of the imports are related with debottlenecking of the plant so if you have more grinding capacity you import clinker as you grind and you achieve your grinding capacity. But you have also other ways of importing and we are doing both, in which you import cement and with this cement you just delivery it to the market directly from the source. So there's these two ways we have been importing and I would say this is something flexible. You can go up, almost up whatever you want. And if you can free a lot of import capability in the United States. So you can almost import in every kilometer of the coast.

Nikkolaj Lippmann: Okay. How many terminals do you have, sorry but is that something you share? Where you own terminals or where you lease access to terminals?

Jaime Rocha: We have access to terminals and we own terminals. Both.

Nikkolaj Lippmann: Okay. Thanks.

Jaime Rocha: You're welcome.

Nikkolaj Lippmann: And the working capital reflection?

Jaime Rocha: Yes, yeah, yeah I believe that Lulu is taking this.

Maria de Lourdes Barajas: Yes, about the working capital, the most important is the independence of these business units. We are not planning to give them money at the moment and we expect the business generate and improve its own working capital.

Nikkolaj Lippmann: Got it. Thanks, guys.

Operator: And once again, that is *1 on your touchtone phone if you would like to ask a question, as well as, you may send your question via the webcast portal by clicking on the question mark icon and typing in your question. One moment while we cue. And it appears that we have no further questions at this time. I'll be happy to turn the call over Jaime Rocha for any concluding remarks.

Jaime Rocha: Thank you all for being on our call today and for your continued interest in Elementia. We look forward to sharing more information regarding the spinoff as it progresses. Please do not hesitate to contact Iris and if you have any additional questions or comments and we look forward to seeing you in the next call and thank you very much and have a good day.

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