Conference Call

Aug, 11, 2016

OPERATOR – Ladies and gentlemen, thank you for waiting and welcome to Eucatex's conference call to discuss its results in the second quarter of 2016. We inform that participants will be in listen-only mode during the Company's presentation. Afterwards, we will begin the Question & Answer session, at which point further instructions will be given. Should any participant require assistance during the call, please press *0 to reach the operator.

Before proceeding, we would like to clarify that any forward-looking statements made during the conference call related to the company's business prospects and its operating and financial projections and targets are based on the beliefs and assumptions of Eucatex's Management and on the information currently available. Forward-looking statements do not constitute a guarantee of performance. They involve risks, uncertainties and assumptions, since they relate to future events and are therefore dependent on circumstances that may or may not occur. Investors are cautioned that general economic conditions, industry conditions and other operating factors could affect the future performance of the company and, consequently, actual results may differ materially from those expressed in such forward-looking statements.

I will now pass the call over to Mr. José Antonio Goulart de Carvalho. Mr. José Antônio, you may begin.

JOSÉ ANTONIO GOULART DE CARVALHO – Good morning, ladies and gentlemen. Thank you for joining in this morning's conference call, during which we'll present Eucatex's results for the second quarter of 2016. In the second quarter, if the results were not that positive, at least it seems that the worst of the past few months is now behind us.

We sense that inflation is slowing somewhat and there's an expectation for cuts in interest rates, along with the initial signs of a recovery in consumer and business confidence.

Obviously, we still have bad news on unemployment, which reached very high rates of around 11%, and for household income, which is exacerbated by inflation and the current high unemployment rate. So, these signs are, let's say, not completely positive, but somehow point to, despite my last comments, a recovery on the horizon.

The indicators for measuring the performance of the construction materials industry, and we always use those from the Brazilian Construction Materials Industry Association (ABRAMAT), remain weak, but showed a slight recovery from the previous period. In the first quarter, the ABRAMAT index was below -17% and now we're at -14%, which also is a bad number, but already shows some improvement.

In the wood panels segment, based on sales volumes in the domestic market plus the export market, which performed really well, sales volume was in line with the same period last year, which was not the case in the first quarter. At the close of this second quarter, we saw a generalized price increase in the industry, which, though still insufficient to significantly improve margins, was sufficient to offset at least the increase in costs.

So, let's start our presentation. We always start by showing, on slide 2, the key figures in the period. Our net revenue grew by nearly 6% to R$ 280 million. In the quarter, growth was slightly more moderate, but still at 2.4%.

Recurring EBITDA was R$ 51 million in the quarter, which was higher in nominal terms, but down slightly in terms of margin. Recurring EBITDA margin was 18.3% in the quarter, compared to around 14.6% last quarter. So, despite the slightly lower margin compared to last year, this represents important improvement.

Net income staged a strong recovery in the quarter of around 80% and in the six-month period of around 100%, which is very strong. We continued to focus on the export market, registering growth in the six-month period of around 40% in sales volume and of around 30% in revenue. Of course, these figures, especially in the past few days, the exchange rate issue is a concern, with some products affected by the current rate, since they become less attractive.

So, this is something to monitor closely. But the fact is that we are still very focused on exports and they are responding very well.

On slide 3, you can see some information on our revenue, with a breakdown by product and segment. As I mentioned before, revenue posted growth in the quarter of nearly 6%. This slide is more of an informational nature, with no major changes from prior quarters. Unless, perhaps, to comment that the export market, as we've been saying, has been increasing its contribution to the company's overall revenue.

On slide 4, you can see the evolution in our exports. On the left-hand side, there's the evolution in revenue, taking as the base of 100 the first half of 2013 and evolving through the first half of this year. We have registered an average annual growth rate of 40%, which is a very strong number. On the right-hand side, you can see the growing importance that exports have to our revenue. We went from 7% in 2013 to 16% now in 2016.

Moving forward, now on slide 5, I want to comment briefly on the performance of the wood segment, which is the company's main segment. If we look at the right-hand side of the slide, the pie chart, you can see the products that make up this segment, which are MDP panels, MDF, fiberboard and laminated flooring.

In the panels segments, we always point out the slice of the pie of MDF panels, from which doors and wall partitions are also made for the construction industry. What's worth noting here is the growing importance of laminated flooring in the composition of the pie chart. I have here that last quarter laminated flooring accounted for approximately 13%, increasing to 16% in the year to date. We had a solid quarter for flooring and even captured a market share gain.

On the left-hand side, you can see the information on net revenue from this segment. It shows stability, with slight growth in the quarter, but with the six-month period stable on a year earlier. If we look at the bottom of the slide, you can see information on sales volume considering both the domestic and export markets.

And then on the left-hand side, you can see that the market staged a very important recovery, which basically was driven by exports. The volume of products being exported is already very significant. In the quarter, I don't have the exact data here, but we exported around 260,000 cubic meters in the quarter, which is already a very significant level. We are talking about 80,000 to 90,000 cubic meters per month, which basically means that the output from one and a half plants is being exported.

So, it's very important that the exchange rate continue to benefit the industry's exports. Our performance ended up lagging the performance of the overall industry in the quarter, growing only 1.5%, compared to 8.7%, which we will discuss on the next slide, when shows our installed capacity utilization rate.

We suffered some production problems in the quarter, which we'll go over in detail later. When we look at the six-month period, on the bar chart on the right-hand side, the situation is the opposite, with volume growth on the prior year outpacing that of the overall industry. The industry, as I mentioned in my opening remarks, registered stability in the first half of this year compared to same period last year.

On slide 6, as I said, I'll comment on our installed capacity utilization in the quarter. Mainly at our Salto plant, where we have the two fiberboard lines and one MDF line, we experienced problems of all sorts in the quarter.

We had very heavy rains during a certain period and even had to stop production because of flooding. We had a power outage that lasted nearly 70 hours.

We also had problems in our wood supply, with a mismatch in relation to the harvest leading us to use very young timber not only at Salto, but also at Botucatu, which has a smaller diameter and higher fright load, and also affected our production process. And at Salto specifically, we had problems with steam generation, so the sum of all these small and medium difficulties ended up affecting the capacity utilization rate.

It's important that we note here that ultimately all of these issues either have been solved or are in the process of being solved. But the truth is, if we look at these bars on the slide, we see that Salto registered a low utilization rate in the production of fiberboard, of 69%. For example, in the last quarter of 2015, the utilization rate was 83%, so this quarter it was low. But, as I said, all these issues are well on their way to being resolved. The HDF plant also suffered, with capacity utilization of 73%. We had closed the year with a rate of 89%.

Also in Botucatu, we have two key numbers, with the larger the capacity utilization rate of our MDP line and the lower the capacity utilization of our laminated flooring substrate line. The combined utilization rate is 83% and, for instance, last quarter, we were at 90%. We also had some negative impacts at the Botucatu plant. The only line that performed better than in previous quarters was the laminated flooring line.

We have a very high capacity, a lot of room to continue growing, but our utilization was at 44% in the quarter, compared to 33% before. Well, at the bottom of the slide, just for the record, we have the breakdown of costs across the different types of panels, panels with resin, which are MDP and MDF, and panels without resin, which is fiberboard. It’s worth recalling, because we’re still comparing this quarter with the same quarter last year, the big impact from the increase in electricity rates around the middle of the same quarter last year.

Just to put this into perspective, electricity – and you can see this in the pie chart on the right-hand side – represents around 12% of the cost of fiberboard, for example. This figure in the first quarter of last year was at 9.5%. So, electricity has really pressured our costs.

Let’s move on to the next slide, slide 7, which covers the paint segment. Looking at the bar chart and table on the right-hand side, you can see that we had a quarter that was good, especially if we compare our performance with that of the overall industry. In the table you can see that we posted sales volume growth in the quarter of 4.4% year over year, while the industry contracted by 7.2%. In the year to date, this growth was insufficient to offset the decline in the first quarter, of 7%, but still better the contraction in the overall market of 10%.

On the left-hand side, you can see the information on net revenue, which posted important growth in the quarter of 9.8%. So, if we compare this variation with the variation in sales volume, you can observe a recovery in price, since sales volumes grew by 4.4% while revenue grew by 9.8%, pointing to an important recovery in our prices.

The same thing happened to revenue in the year to date, which, although practically stable, compares to the drop in sales volume of 7%. On the left-hand side, we have information on costs, and there isn’t much to comment. On the right-hand side, you can see the installed capacity utilization rate. Also in the paint segment, we had a great opportunity to continue growing without new investments. We are at a capacity utilization rate of 53%, which is around the same level of the previous semester.

On slide 8, you can see our summarized income statement. Some or actually most of these results I've already discussed. Net revenue growth was nearly 6% in the quarter and 2.4% in the year to date.

Gross margin was around 29% in the quarter, stable compared to a year earlier, but in the year to date was still down somewhat from the same period last year. The first quarter of this year was truly very difficult.

On expenses, we had, you can say, a good performance in administrative expenses. These are basically formed by services and labor, which are items that generally follow the path of inflation, but instead of increasing, administrative expenses fell 2.7% in the quarter. This already reflects the results of the program we developed internally to review the scope of services, restructure our administrative activities and streamline our workforce.

Selling expenses increased, but, as we know, some items in selling expenses are variable costs that vary in line with revenue and, as revenue increases, it's only natural that these expenses increase too. But there's also an impact from exports. The costs associated with exports are higher than those for domestic sales, so this also explains part of the increase.

Our results for revenue, margin and expenses generated growth in recurring EBITDA in nominal terms to R$ 51.3 million, compared to R$ 49.7 million in the prior period. However, recurring EBITDA margin was down from last quarter, at 18.3%, compared to 18.8%. And in the six-month period, recurring EBITDA margin was also down slightly from last year, mainly due to the first-quarter results, which was close to 14.5% or 14.6%. Another result we must highlight is non-recurring items, which increased substantially this quarter, which is due to the restructuring in the company's workforce that I mentioned.

These items included severance pay and other labor-related items. And last, for recurring net income, which is typically our primary focus, we had important improvement. And in reported net income too, which grew by around 80% year over year.

Let's move on to slide 9, which shows our debt, where can see there were reductions in both gross debt and net debt. Significant reductions. Nevertheless, we have this reduction of around R$ 30 million, R$ 27 million.

The net debt/EBITDA ratio was unchanged from the end of the prior year, at around 1.7 times, which is due to the fact that we had relatively lower EBITDA in the first quarter. So, in the year-to-date figures, it was stable. But if we take, for instance, annualized EBITDA in the second quarter, this ratio of 1.7 would fall to around 1.5 times.

In terms of our short and long-term debt maturity profile, as we've mentioned before, we haven't finished. We have a long-term export payment facility that we haven't fully drawn down. As we draw from this facility, and we are monitoring the exchange rate to reflect better on this, but then we would be reducing the short-term debt. There was no big change in the level of foreign-denominated debt. The ratio of foreign currency to domestic currency hasn't changed a lot from prior periods. We've been able to maintain this, let's say, relatively high level precisely because of the support we've had from exports.

On slide 10, you can see our investments in the quarter of around R$ 20 million, which was almost completely focused on sustaining capex. We are very conservative in terms of investment and focusing only on those needed to sustain our industrial and forestry operations. This year, with project investment of R$ 80 million, which should be around 10% less than what we invested last year, which was around R$90 million. And the R$20 million this quarter is well in line with this target.

This is the last slide, slide 11. It's also merely for the record, more than anything else. It's important to look at forestry performance, since practically 80% of our revenue comes from our forest base. So we have 79 farms with a total of 46,000 hectares, all of which are in the state of São Paulo. The table on the upper left-hand side shows the average supply radius of the timber harvested in the quarter. Salto always has a slightly longer supply distance than the forests in Botucatu.

On the other hand, Salto is always closer to consumer markets, especially for exports, since it's much closer to the Port of Santos, so it benefits in terms of distribution. On the bottom left of the slide, you can see our planted forests and seedling management. We had already called your attention to the fact that, since 2014, we've been managing a portion of our forests, which means we have harvested and managed the re-sprouting. This has led to significant reductions in forestry investment without any significant loss in yield.

On the right-hand side, you can see our recycling program, which we've been conducting for some time now. We increased the volume significantly in the last six months, by nearly 40% compared to the previous six-month period. And then we always present the comparative gains, in other words, considering that we, instead of using recycled materials, were using forests or wood from planted forests.

So, basically, that was the information I wanted to share with you. We're now available to take any of your questions. Thank you.

OPERATOR – We'll now start the Question & Answer session. To ask a question, please dial *1. To remove your question from the queue, dial #. Please wait while we gather the questions.

Our first question comes from Mr. Lucas Ferreira from JP Morgan.

LUCAS FERREIRA – Good morning, José Antônio. You already have capacity utilization affected by the operational problems you had in second quarter, perhaps above 80%, and the market is expected to resume growth in the coming years. I was wondering if the company has any plans to start thinking about expanding its capacity. You have a relatively low leverage ratio. That is, if you have the forest assets for a potential expansion.

And my second question is regarding the panels market. How you see it and whether or not the third quarter has been in line with your expectations in terms of sales volume. We saw that the industry probably had two moments of price increases in the second quarter, with discussions perhaps of a third increase in the second half of the year. Is this something, in your opinion, that could still happen or that perhaps will be postponed until next year only. Could you give us a bit more detail on the behavior of demand. Thank you.

JOSÉ ANTÔNIO GOULART DE CARVALHO – Good morning. Thank you for your question. So, let's start with the question on expansion. Indeed, our leverage is not that high.

Now, when we look at the industry, first of all, when we compare the figures for consumption in Brazil, per-capita consumption in square meters, we see that the figures are already very strong, even compared to more developed countries and wealthier economies. So, from two aspects, we see that the market is well served, I mean, the market has relatively strong per-capita demand.

And, on the other hand, there is a very large amount of idle capacity. This year alone, we saw the startup of two new lines. One MDP line at Berneck, which has even come online according to our latest information, but that is still lacking certain equipment to be able to ramp up to full capacity. And they are already starting a second phase of the project to be able to operate the plant at full capacity. And there is also the MDF line at Guararapes, which has started operations.

So, the market is well served. Capacity utilization, considering the full capacity available, is still low. Even when growth recovers, it there's substantial growth in demand, there's still a lot of capacity to meet this demand.

So, I have some reservations about starting to expand in this industry. What we've been doing is trying to identify products or opportunities more related to the construction industry. We recently started to sell vinyl flooring and we now have a line of skirting boards. And we're assessing other opportunities to add new products – not necessarily by investing in plant expansions – that could benefit from Eucatex's knowledge and penetration in certain channels. Anyway, but with a focus on the construction industry.

In the panels market, as we shown, the market has responded. And it responded not just in the domestic market, but especially in the export market. July posted growth on the same period last year, but was down somewhat from June. So, I think the market will be more or less close to what we are seeing, kind of flat compared to last year in terms of domestic performance.

And in terms of exports, we hope they continue to grow. And that, of course, takes some of the pressure off manufacturers to sell their products domestically. And it enables, or it enabled, these opportunities that you mentioned of price increase, which actually happened. I don't know if there will be room for another price increase this year. It will depend a little on market behavior over the coming months. Who knows, maybe in October or November? We'll see. It'll depend a little on the behavior of demand. I hope my responses were useful.

LUCAS FERREIRA – It helped a lot. Thank you very much.

OPERATOR – Once again, as a reminder, to post a question, please dial *1. And to remove your question from the queue, dial #. If you have a question, please dial *1.

There being no further questions, I'd like to call on Mr. José Antônio for his closing remarks. Mr. José Antônio, you may begin.

JOSÉ ANTÔNIO GOULART DE CARVALHO – Well, once again, thank you for participating in this morning's call. I think that, as a message, we should close the presentation with an optimistic outlook for the coming months. I think that we will finally move towards a more stable and more predictable scenario. And that gradually has supported a recovery in consumer confidence and in business confidence, which is key to any kind of recovery.

And we see this happening. And, of course, now, from the standpoint even of sales volume, we are starting the second half, which is seasonally better than the first half of the year. So we should see better days and months for demand in this second half. So those were my comments. Once again, thank you and have a good day.

OPERATOR – That concludes Eucatex's conference call. Thank you for participating and have a good day.

About Eucatex

Eucatex S.A. Indústria e Comércio completes 65 years in 2016 and is one of Brazil's largest manufacturers of laminated flooring, wall partitions, doors, MDP/MDF/T-HDF panels, fiberboard, and paints and varnishes. It operates five modern plants in Botucatu and Salto (both in São Paulo) and Cabo de Santo Agostinho (Pernambuco), employing 2,455 people. Its products are exported to more than 37 countries. For more information, visit ri.eucatex.com.br.

This release contains forward-looking statements related to the business prospects, estimates of operating and financial results, and those related to the growth prospects of Eucatex. These are merely projections and as such are based exclusively on the expectations of Eucatex management concerning the future of the business. These forward-looking statements substantially depend on market conditions, the performance of the Brazilian economy, the sector and the international markets and therefore are subject to change without prior notice.