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PRESENTATION

Operator

Good morning, and welcome to the Orbia's First Quarter 2021 Earnings Conference Call. As we turn to Slide 1 (Operator Instructions). Please note, this event is being recorded. I will now turn the conference over to Mr. Javier Luna, Orbia's, Capital Markets and Investor Relations Director. Please go ahead, sir.

Javier Luna - *Orbia Advance Corporation, S.A.B. de C.V. - Director of Capital Markets & IR*

Thank you, Garet. Good morning, and welcome to Orbia's First Quarter 2021 Earnings Conference Call. We appreciate your time and participation today. Joining me are Sameer Bharadwaj, CEO; and Edgardo Carlos, CFO. A friendly reminder before we continue, some of the comments today will contain forward-looking statements based on our current view of our business, and actual future results may differ materially.

Today's call should be considered in conjunction with cautionary statements contained in our earnings release and in our most recent periodic BMV report. The company disclaims any obligation to update or revise any such forward-looking statements.

With that, let me now turn the call over to Sameer.

Sameer S. Bharadwaj - *Orbia Advance Corporation, S.A.B. de C.V. - CEO*

Thank you, Javier, and good morning, everyone. Let me start by thanking Orbia's 21,500 plus associates for their dedication to the company and to serving our customers on a journey to advance life around the world. Although the pandemic is not over, the initial rollout of the vaccine gives us reasons to be optimistic. When vaccination becomes more prevalent in the regions in which we operate, we look forward to returning to normalized working conditions.

In the meantime, we continue to remain vigilant about employee health and adhere to rigorous safety and sanitation protocols.

Let me now provide a high-level overview on the first quarter's very positive business performance. I'm on Slide 3. First, Orbia delivered another strong consecutive quarter and better-than-expected results in the face of adverse weather, supply chain interruptions, rising raw material cost, and persistent COVID pressures.

Our diversified, well positioned portfolio of businesses delivered year-over-year revenue and EBITDA growth of 18% and 46%, respectively. 3 of our businesses: Polymer Solutions, Wavin, and Netafim experienced especially strong end market demand, which helped offset rising raw material costs and the supply disruptions from winter storm weather in several regions of the United States. Here is additional color in relation to those 3 business groups.

Polymer Solutions delivered another very strong quarter, effectively managing challenging weather conditions that caused significant operational disruptions in most of the U.S. Gulf Coast region and resulted in record PVC pricing.

As we have been telling you for some time now, even after the PVC supply disruption goes away, we believe that prices will likely settle at a comparatively higher level until more capacity is added, which normally takes 2 to 3 years to become operational. Wavin posted a strong performance across the board in Europe, Middle East, and Africa, and Latin America, with strength across countries, particularly Germany, the United Kingdom, Brazil, Mexico, and Colombia.

Weather-related material scarcity and higher pricing triggered some inventory buildup in March. The business continues to expand its market share in the more attractive aboveground segment, while also investing in high potential regions such as India. Netafim also experienced strong demand in most markets as commodity prices are strong and there is very active global trade in the face of rising prices.

Second, we are executing with agility and focusing on what we can control. EBITDA grew solidly with double-digit margins despite raw material inflation across some of our businesses.

As we discussed in our previous call, we had already begun to see cost pressure last quarter and moved to mitigate the impact taking price actions across all our businesses. However, there is a lag in some businesses between rising raw material costs, and when we will see the benefit of these commercial actions.

What we could not predict was the implement weather in the United States that impacted many of our businesses. It is difficult to estimate how long it will take to fully resolve some supply disruptions, but we are focused on sourcing from all possible channels and meeting our customers' requirements. We are, right now, working through these issues and expect to see some resolution in the coming weeks.

Finally, our free cash flow was negative during the quarter because of the higher working capital requirements from increased levels of activity and rising raw material costs.

With that, let me turn the call over to Edga to go through our financial performance in further detail. Edga?

Edgardo Carlos - *Orbia Advance Corporation, S.A.B. de C.V. - CFO*

Thank you, Sameer, and good morning, good afternoon, everybody. We delivered another quarter of very strong results. On a consolidated basis, our net revenues for the first quarter were $1.9 billion, up 18% year-over-year, driven primarily by the strong growth in Polymer Solutions, Wavin, and Netafim. In the quarter, we achieved an all-time record EBITDA of $451 million, up 46% with margin expanding 455 basis points.

We continued to focus on operational efficiencies, running our facilities at full capacity as well as identifying cost reduction opportunity. We have also taken actions to mitigate the raw material increases through an effective commercial strategy and adequate inventory management.

Now let me share some color on the performance by business. So please turn to Slide #4. In Polymer Solutions, revenues were up 21% on a strong PVC pricing from supply constraint driven by U.S. weather disruption and consistently high demand on the building and construction market.

PVC prices continued at historical high levels driven by global supply scarcity. EBITDA was up 86% -- 85% with a margin of 31.6%. We expect PVC demand to continue to be very strong for the remainder of the year despite our expectation that PVC might start to ease towards the second quarter of this year as supply stabilizes.

Wavin revenues were up 33% from higher volume, primarily in LatAm amid increasing demand for building materials and construction solutions. While we experienced raw material price increases and supply constraints, we offset most of the impact with operational cost improvement, several price actions and increased volume of high value-added products. We were able to meet demand despite raw material scarcity due to our vertical integrated business model.

EBITDA reached $95 million, up 86% with a margin improvement of 418 basis points. We expect that demand will continue to be strong globally and, in this environment, we will be expanding our footprint in the coming months to accelerate organic growth.

Most recently, we started adding capacity for new high value-added products in Europe as well as repurposing a facility in India for Wavin production, which are expected to be operational in early 2022.

Now let me turn into Netafim, which revenues increased by 19% on a broad-based geographical demand. EBITDA grew by 41%, with margin expanding by 318 basis points. This growth was driven by operational efficiencies, volume growth and combined expense management, partially offsetting the strong increase in raw material that we experienced. We expect demand to continue to be very strong, although -- and even globally, mainly depending on the status of the vaccine rollouts.

Dura-Line revenue increased 8%, driven by continued demand in North America and Europe. However, volume in the first quarter was negatively impacted by supply chain shortage and customer delays of fiber deployment due to the adverse weather in the U.S. EBITDA was flat, with margin down 126 basis points, primarily due to higher raw material costs.

In the second quarter, we expect overall a strong market demand, a recovery from Q1 temporary volume contraction.

Again, we are actively working to execute appropriate price and cost management actions. Koura revenues and EBITDA declined by 5% and 18%, respectively, from continued COVID related impact in the assets for aluminum fluoride as well as some supply chain disruption, primarily the [TCE]. We expect demand to recover as the aluminum sector outlook improves with the benefit to the business likely starting in the second half of this year and extended into 2022.

In sum, although all of our businesses were impacted by adverse weather, supply chain disruption, and raising raw material costs, we were able to achieve extraordinary performance in the quarter. We remain on a laser-focused approach on cost control and cash generation. Focusing on realizing further efficiencies, improving asset utilization, and implementing price actions to continue delivering strong results.

And moreover, our vertical integration will provide us with a natural hedge against commodity inflation. Now let me turn into Slide #5, please. And as Sameer discussed earlier, our free cash flow for the quarter was negative mainly due to an increase in working capital, following a very strong sequential growth in sales. This increase in working capital was primarily due to a higher level of account receivables with a strong concentration of sales in March as well as higher inventory costs associated with raw material price increases and to some extent, building up additional stock to support higher activity levels.

For the full year, we continue to expect strong cash generation as market continue on a recovery path and supply chain improve with very limited additional investment requiring working capital aiming to reach a free cash flow conversion ratio to EBITDA exceeding 30%. CapEx of $53 million was down 12% as we had some project delay related to lack of mobility in some regions due to COVID. However, in the quarter, we accelerated approval of several organic growth projects to be deployed during this year and next year.

Our strong balance sheet will allow Orbia to continue grow mostly organically and with some bolt-on acquisition. Our net debt stood at $2.9 billion at the quarter end, representing a 1.97x ratio to EBITDA, one of the lowest level reached after the acquisition of Netafim in early 2018. With that, let me turn back to Sameer, please.

Sameer S. Bharadwaj - *Orbia Advance Corporation, S.A.B. de C.V. - CEO*

Thank you, Edga. Next, I want to outline our thoughts on capital allocation on Slide 6. We think about capital in 3 areas: one, reinvestment into the business to run the day-to-day operations, and this includes maintenance, compliance, and information technology-related investments; two, capital for growth, both organic and inorganic; and three, cash returns to shareholders.

We think about all 3 equally but prioritize allocation with an eye on sustainable long-term returns above our weighted average cost of capital. Historically, our CapEx has been allocated roughly 60% to day-to-day operations and 40% to growth investments.

This quarter, however, we continued pivoting towards growth with roughly half of our approved CapEx directed towards projects such as Wavin India investments and additional capacity in the United States for Dura-Line.

As we think about investment areas in general, we are prioritizing organic opportunities to capture the strong demand we see in our end markets. Our focus areas are to expand our downstream footprint within our value chain, to grow our services business and create a strong aftermarket presence, which will support higher levels of recurring revenue and to look at new geographies and technologies that will help us scale globally.

And as it pertains to returning cash to shareholders on March 30, 2021, at Orbia's Annual General Shareholders' Meeting, we approved an ordinary dividend of $0.10 per share, which equates to a yield of more than 4%. We paid the first of 4 installments of $0.025 per share on April 14. We will also buy back stock from time to time, of course, prioritizing growth investments first.

Can we switch to Slide 7, please? Now let me talk about our growth strategy. We are focused on operational and commercial excellence and driving value for our shareholders through disciplined investments. Particularly, as we continue to build out our product portfolio, the opportunities to grow our business become massive. As examples, we announced the tuck-in acquisition of Gakon, which supports Netafim's business strategy to become the leading greenhouse player in the market and provides access to differentiated technology.

In Wavin, we are making significant commercial progress in storm water management and indoor climate products and solutions. And in Koura, we just announced an investment in a lithium-ion battery recycling technology company with battery resources, which I will talk about more shortly. We have a strong pipeline of opportunities, and we'll remain balanced and focused on both short-term and long-term execution.

It's worth talking about what we mean by growth. This entails geographic growth, growth downstream, growth in new services, acquiring new technologies and capabilities, and leveraging them worldwide.

On the foundational topic of sustainability, let me briefly discuss a few of the achievements this quarter on Slide 8. First, along with funding from several other firms, we led and announced a $4 million venture capital investment in battery resources to develop a commercial processing facility for converting used lithium-ion batteries directly into cathode materials.

While a small operation today, we are focused on meeting a critical need for the fast-growing EV battery market and an electrified future. Building on our relationship with the Tent Partnership for Refugees, we took steps to hire refugees in Colombia at our Wavin operations and have defined 7 priority countries where the possibility of hiring refugees is being pursued.

In collaboration with Mexico City's authorities, we have inaugurated the first plastic road project in Latin America, located in Mexico City's Chapultepec Forest. The plastic road pilot is a smart climate adaptive bicycle path made from over 2,200 pounds of plastic waste, the equivalent of 0.5 million plastic bottle caps, effectively recycling plastic waste, reducing the carbon footprint of the road by 72% and addressing Mexico City's portable water challenges in the wake of climate change.

Finally, we will be publishing our task force on climate-related financial disclosures document and our 2020 sustainability report in the next few days. We are very proud of the impact Orbia is having on our communities globally as we advance light around the world.

Let me now address our expectations for 2021. I'm on Slide 9. We see the global economies and demand continuing to recover with governments planning large investments globally for infrastructure and societal needs.

In this context, Orbia's businesses had a stronger-than-expected performance during Q1, and we expect favorable market conditions to continue into the second quarter. Therefore, and based on the current assumptions about the future course of the business, we now expect 2021 EBITDA to increase 15%, with upside potential if strong conditions prevail. Orbia reiterates its CapEx guidance in the range of $350 million to $400 million for the year.

Although we remain encouraged by demand levels, we continue to keep a close eye on the environment, specifically continued COVID-related impacts, supply chain bottlenecks, and raw material cost increases.

Let me close by reiterating that we are optimistic about Orbia's resilience as a business, our performance so far this year, and the future opportunities in front of us. We will remain disciplined and focused on successfully navigating the short-term issues of raw material costs and scarcities, while accelerating our strategy to deliver higher growth, profitability, cash flow, and returns.

There are opportunities for each of our businesses to improve earnings streams and generate cash in a more efficient way, and we intend to stay on top of those. And of course, we remain committed to returning capital to our shareholders through a healthy dividend.

Simply said, we are confident in our outlook and are focused on capturing the opportunities in front of us as we show up for our stakeholders. Thank you. Operator, we are ready to take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question comes from Ben Isaacson of Scotiabank.

Unidentified Analyst

This is Ziad on for Ben. Congratulations on the quarter. And I just have a few, if I may. First in Dura-Line, you talked about the earnings that coming from unfavorable weather and a constrained fiber deployment. Can you talk a little bit about whether or not there's a possibility that could be transferred over to Q2? Should we see a potential uplift there? And to the extent that you're able to, can we quantify just how much that hit was?

And then my second question on Koura. Can you talk a little bit about the situation on illegal importation of refrigerants, maybe what the long-term implications of that might be on your business?

Edgardo Carlos - *Orbia Advance Corporation, S.A.B. de C.V. - CFO*

Okay. Thank you for the question. Let me address the Dura-Line. And probably, Sameer, you will go over the Koura question. It's true that there was some disruption and it's affected approximately $5 million EBITDA in the quarter for delay into the second quarter. But clearly, we do see, in Dura-Line, still in the second quarter, a strong pressure on the raw material prices. And as you know, we have a very long-term contract with several of our key customers in the U.S.

So we are really moving forward with the new prices to overcome the increase in raw material. We had expected that prices to be up today with the raw material by the end of the second quarter. It is very important to mention that also that normally, the first quarter is very low because of weather in general.

And the second quarter, we had expected a significant improvement in terms of volume and profitability compared to first quarter.

Sameer S. Bharadwaj - *Orbia Advance Corporation, S.A.B. de C.V. - CEO*

Ben (sic) [Ziad], welcome to the call, and thank you for your question. Let me take the Koura question as I've been close to dealing with this situation. We are now at a stage where, after working closely with the European authorities on various aspects of addressing this issue. We believe we are beginning to see traction in terms of seizures of illegal imports, better training of customs officials, and the European Union is committed to building a single window system that will give the customs officials the right tools to prevent the smuggling of the illegal imports.

And so it's a long-term -- it's a marathon. It's a long-term effort to weed out this problem. But we are encouraged that the efforts that we are seeing, in collaboration with other industry participants and in collaboration with the authorities.

We were also encouraged to see the USTR include this issue in the latest publication of the National Trade Estimate, and this is a very important development because it allows us to use this as a lever in our conversations with the member states to help them appreciate the problem and take stronger actions at a member state level.

Operator

(Operator Instructions). The next question comes from Scott Piper with IAM.

Scott Piper - *Itau USA Asset Management Inc. - Portfolio Manager*

Simple question. Just any thoughts on possibly listing your shares outside of Mexico, given the growing operational footprint outside of Mexico itself?

Sameer S. Bharadwaj - *Orbia Advance Corporation, S.A.B. de C.V. - CEO*

So thank you, Scott. It's a good question. And we are always looking at ways to make our shares more accessible and unlock value for our shareholders. And we have been working steadily towards improving -- achieving SOx compliance, but it's not the highest priority at this time. While we are working our way towards that, our first priority will be to focus on value creation opportunities we see in our businesses.

And then as we go along, we will look for various opportunities to unlock that value. And some of these options include looking at a dual listing or listening elsewhere.

Operator

Our next question comes from Luiz with Carvalho (sic) [UBS].

Luiz Carvalho - *UBS Investment Bank, Research Division - Director and Analyst*

Congratulations on the results. Sameer, I have basically 2 questions. Even under a very strong quarter, when we look to the -- both the operational cash flow and the, let's say, the cash flow of the company, you actually burned some cash, right?

So I know there was an impact from the working capital, but I'm just trying to understand if you can give us a bit more color on the impact and the potentially current levels.

The second question, it's something that we have been, let's say, struggling to understand a bit better looking forward in a bit more structural way, what would be it to the company, how I can say, strategy on the capital allocation?

In your presentation, you shared one slide, which I thought that was pretty interesting that you have some, I don't know, let's put this way, maintenance, organic and I don't know, potential buybacks and dividends.

So you have now a leverage close to 2x that is potentially decreasing with, let's say, with the guidance that you just provided in terms of EBITDA for the rest of the year. Just trying to understand, as of now, where you see the priorities within these 3 pillars that you share with us?

Edgardo Carlos - *Orbia Advance Corporation, S.A.B. de C.V. - CFO*

Luiz let me address the first one. Yes. Let me address the first one in terms of -- and thank you for the question, in terms of the cash generation. As I mentioned in my opening remarks, and in spite of the growth of account receivables and inventory, it is very important to see that the days of sales and days of inventory remained practically flat compared to December and -- however, what we decided is to use efficiently our cash.

So we were able to, to some extent, make some payments in advance or shorten the payment terms to suppliers to get discount and also to secure raw material. So at the end of the day, what you see is an increase in inventory that is not correspond to the increase in suppliers. And this is basically the purpose of us for using the cash more efficiently overall.

So we -- as I mentioned, we do see very small increasing working capital starting in the second quarter, while we see that this, by far, the most strong quarter in the year, and we will see a recovery on working capital and very strong free cash flow to be generating starting in the second quarter of this year.

Sameer S. Bharadwaj - *Orbia Advance Corporation, S.A.B. de C.V. - CEO*

Great. Luiz let me take the second question here. And that's a great question. If I reflect upon the environment we are in right now, we have a strong tailwind in our Polymer Solutions business. We have a -- we are anticipating a strong post-pandemic rebound across most of our markets and strong infrastructure investments around the world.

And so -- and then also, we're also in the context of a very low cost of leverage, right? And you rightly asked in that context with decreasing leverage, what's our focus going to be? And I can tell you, unequivocally, our focus is going to be on growth. And we will be being very disciplined as we make growth investments.

But as I look at all of our businesses from Polymer Solutions to Koura, AlphaGary, Wavin, VESTOLIT -- Wavin, Dura-Line, and Netafim. We have many projects in these businesses, organic growth opportunities where you can get EBITDA at a multiple of 1.0 to 4.0x, right. And you contrast that with buying companies for 10x or 12x, when you have such good organic growth projects, these have a significant impact on improving the ROIC over time. And so the focus will be on literally getting traction on these organic growth projects.

In addition, we will be looking at smart bolt-on acquisitions that give us access to either new geographies and where we can take our existing products and technologies or acquiring new technologies and capabilities like the Gakon acquisition to which we can provide geographic leverage worldwide. And so right now, as I would say, our focus will be on the middle bucket, prioritizing growth investments, but in a smart way, such that it is ROIC accretive.

Luiz Carvalho - *UBS Investment Bank, Research Division - Director and Analyst*

Very clear. Congrats again.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to CEO, Sameer Bharadwaj, for closing remarks.

Sameer S. Bharadwaj - *Orbia Advance Corporation, S.A.B. de C.V. - CEO*

Well, thank you, everyone. We appreciate your participating on this call. To conclude, I'd like to say that we are very well positioned to continue to capture growth and are confident in our ability to deliver strong returns as we support our stakeholders and communities worldwide. Thank you for joining us today.