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Alejandro Azar, GBM

PRESENTATION

Operator

Good morning and welcome to GCC's First Quarter Earnings Call for 2022. Before we begin, I would like to remind you that this call is being recorded and all participants will be in listen-only mode. Please also note a slide presentation will accompany GCC's earnings results webcast. The link is available on the company's website at gcc.com, within the Investor Relations section. There will be an opportunity for you to ask questions at the end of today's presentation.

I will now turn over the call to Ricardo Martinez, Head of Investor Relations. Ricardo?

Ricardo Martínez

Thank you, operator. Good morning, everyone and thank you for joining our earnings call. We will begin today's discussion with remarks from Mr. Enrique Escalante, our Chief Executive Officer, followed by financial highlights from the quarter by Luis Carlos Arias, Chief Financial Officer. We will then close with your questions.

As a reminder before we begin, today's discussion contains forward-looking statements about the Company's future business and financial performance. These are based on management's current expectations and are subject to risks and uncertainties. You can find more information about risks, uncertainties and other factors that could affect our operating results in our most recent filings with the Mexican Stock Exchange.

As seen on slide 2, our forward-looking statement provides information on risk factors including COVID-nineteen that could affect our financial results. In particular, there is significant uncertainty about the duration and contemplated impact of the pandemic, the geopolitical and economic situations. This means GCC's results could change at any time, and the outlook provided is a best estimate based on information available today.

Let me now turn the call over to Enrique.

Enrique Escalante

Thank you, Ricardo, and good morning, everyone.

GCC is off to an excellent start this year, with a good first quarter and encouraging market trends for 2022.

Let me now briefly discuss our key highlights from our performance this quarter as well as market conditions and some of the challenges we faced. Luis Carlos will follow with GCC's financial results. He will then turn the call back to me for closing remarks and comments about our full-year guidance. Finally, we will take your questions.

Turning to slide 3, our first quarter results were above expectations, despite the challenges faced at every turn:

- high inflation levels coupled with interest rate hikes,
- supply chain & labor shortages
- the continuing pandemic
- and a war in Ukraine along with significant economic sanctions against Russia

Those issues have serious implications throughout the industry and have highlighted GCC's competitive difference. The company's vertical integration of our raw materials and coal, lowers costs and reduces fuel price volatility.

Markets continue very strong, and although we face some challenging obstacles in the landscape, we are very pleased with the results delivered during this first quarter and proud of the way we are overcoming these challenges. We are encouraged by our full-year backlog.

Turning to slide 4, to comment on U.S. operations:

Overall performance and market conditions were better than expected in the first quarter. Total cement volumes increased 10% while ready mix volumes rose 16%. As a result, U.S. sales increased 21%.

During the quarter our operations teams focused efforts on building up inventory. Several plants had planned maintenance outages to ensure consistent production levels in preparation for a strong construction season. In response to this busy season, for a second year in a row every kiln at GCC will be up and running to produce cement.

Regarding U.S. segments, I would like to briefly update:

- **Infrastructure:** Projects are running at a steady but lower pace than other years, as states and DOTs are preparing for additional funding from the already-approved U.S. Infrastructure Investment and Jobs Act.

  In response to this situation, we have been more selective in supplying these types of projects, switching shipments to more profitable segments.

  This market has an upside in the mid-term, as the infrastructure bill will extend the cement cycle through the life of the program. It is expected that additional demand will start increasing in late 2023.

- **Residential:** According with the latest PCA forecast, the expected FED interest rate increases will slow down the housing market growth with more emphasis next year. However, in GCC we have not felt a negative impact as we continue with strong demand in this segment as housing buyer demand is surpassing housing inventories.

- **Non-residential and commercial sector:** Distribution centers, warehouses and e-commerce related projects are driving our sales in this segment. We are not seeing a decline in volumes as we saw in the last two years.

- Finally on **oil well cement demand in the Permian Basin:** Oil price increases, strong drilling activity, as well as the surge of economic activity has boosted this segment. GCC's Odessa cement plant is running at full capacity with supplemental cement coming in from the Chihuahua Plant.

Regarding U.S. pricing on slide 7, on January 1 the 6% to 8% price increase came into effect across all our construction cement markets, whereas oil well cement price increased US$15 per ton on April 1. To date, these price increases have been well received by our customers and as a result, cement prices rose 10% in the quarter.

It's also important to note that based on cost inflation pressures and market conditions, we announced a second price increase of US$8 per short ton in construction cement, effective on July 1, one month earlier than last year's second price increase. We remain optimistic about market response for this second price increase

In an effort to increase margins, we are offsetting incremental costs as we capitalize on market opportunities. In the current environment of very tight supply, most of our customers are significantly more concerned about ensuring uninterrupted supply. And GCC is uniquely positioned to guarantee product availability.

With an eye on improving EBITDA margins in a high-inflation environment, one of our top priorities for the executive team in the short term is to implement cost savings and higher efficiencies in fuel mix by accelerating the proportion of coal versus gas from our mine, increase usage of alternative fuels and very importantly continue to optimize the distribution network to save on freight. Maintaining a high plant utilization will definitely improve our fix cost absorption.

All in all, U.S. performance and the backlog remains encouraging and in line with the full year guidance that we provided last quarter.

Turning to our Mexico operations on slide 9, during the fourth quarter of last year, we announced a double-digit price increase in Mexico effective in January 2022, which motivated our customers to build up a significant inventory at year's end. Therefore, bagged cement volumes were affected this quarter, resulting in a decline of 5%, while ready-mix volumes rose 10%.

High demand of our products remains favorable mainly driven by continued activity from industrial warehouse construction, other commercial and housing projects and strong mining activity. We do not expect customers' high inventory level situation to continue for the remainder of the year. Cement price increased 13% and ready-mix 7%; as a result, Mexico's sales increased 8%.

I would like to point out that our three cement plants in the state of Chihuahua are running at full capacity. And given our strategic location close to the U.S. markets, every cement ton that is not sold in Mexico is being exported to the states, thus, leveraging GCC's unique distribution network.

Let me now turn the call over to Luis Carlos to discuss the quarter's financial results and our cement growth projects update. Then I will return for comments regarding our full-year guidance and closing remarks.

Luis Carlos Arias

Thank you, Enrique, and good morning, everyone.

Turning to slide 11, as noted in our quarterly financial statements released yesterday, for the first quarter, consolidated net sales increased 16%. During Q1, we saw a sharp increase in cement volumes in the U.S. and ready mix in Mexico along with a better price environment in both countries. These gains were partially offset only by cement volumes in Mexico related to distributors' high inventory levels that Enrique explained.

On slide 12, cost of sales as a percentage of revenues decreased 0.7 percentage points to 73.9% in the quarter, mainly reflecting favorable selling prices and operating leverage in both divisions, somewhat offset by unfavorable cost of production and sales mix as well as higher freight costs and a mix effect for higher supplementary oil well cement shipments from Chihuahua to the Odessa plant, given these sales have a lower margin than the rest of cement sales.

SG&A expenses as a percentage of sales decreased 0.4 percentage points in the quarter to 10.9%.

I would like to highlight GCC´s operating income which rose 23% and our operating margin increased 0.9 percentage points. This shows that we are successfully offsetting the increase in costs.

As a result, as we illustrate on slide 13, EBITDA increased 10% in the quarter while the EBITDA margin was 26.4%.

Turning to slide 14, net financial expenses totaled US$14 million due to a one time increase in financial expenses as a result of the prepayment of the 2024 notes and the bank debt.

As a result, earnings per share and consolidated net income decreased 14% to US$13 million so far in 2022.

Moving to our cash generation on slide 15, due to the seasonal nature of our business free cash flow was negative US$1 million in the first quarter 2022, compared to US$18 million in 2021. This was mainly driven increased maintenance CapEx, interest expenses and temporary working capital requirements, offset by higher EBITDA generation and lower cash taxes.

GCC's improvement in controlling payables, receivables, and inventories continues to be remarkable. Based on the last twelve months of sales, we reduced days in net working capital from 49 to 41 - an 8 day decrease in total.

Turning to our balance sheet, we ended the quarter with US$640 million in cash and equivalents.

Our net debt to EBITDA ratio remained in -0.4 times at the end of March. Thus, we continue to be in a very solid financial position with leverage ratios significantly below the industry's average

Turning to our organic growth projects on slide 17

As we have previously said, estimated cement consumption in the coming years associated with the already approved infrastructure bill is sizable. We will take advantage of the time gap between the approval and the actual increase in demand to prepare for what is expected to be a new phase of the industry cycle.

We are investing around US$500 million in the next three years to increase cement capacity to approximately 1.3 million metric tons, 20% above our current installed capacity. Our teams are working closely with technology and equipment developers to meet the deadlines of two hundred thousand metric tons by the first half of 2023 and 1.1 million metric tons by 2024.

Changing subjects, the Board of Directors has approved the recommendation to the Annual Shareholder Meeting, to pay an annual dividend of $1.1621 Mexican pesos per share on May seventeenth. This represents a 15% increase against last year's dividend.

As a comment on GCC's share price, we believe that our stock price doesn't truly reflect our positive momentum and solid financial position and has been impacted by market volatility and uncertainty across the economy. While we don't manage GCC based on the share price in the short term, in the long term our share price is a measure of the progress we have made over the years. The stock price has increased around 300% since 2014.

Therefore, to support GCC's share price we will reactivate our share buyback program and expect to make additional opportunistic share purchases in accordance with market conditions. This program reflects our confidence in the execution of our business plan and the positive outlook as well as increasing shareholder return. We are confident that eventually the market will completely recognize GCC's fair valuation, aligned with our ROIC return, one of the highest in the industry.

With that, I will now hand the call to Enrique for his closing remarks.

Enrique Escalante

Thank you, Luis Carlos.

Turning to slide 19, I would like to take this opportunity to reiterate the fact that for the rest of the year, our cement business looks promising across the board. For practical purposes, our system is sold out, and it is supported by a strong, full-year backlog. We stay vigilant for a possible soft-landing or short-lived recession next year. However, it is early to know, but in any event, we believe the short term remains very strong for GCC.

We, therefore, maintain our 2022 guidance provided in last quarter's conference call. Absent of an early winter resulting in a shorter than usual construction season, we should be on pace in the next months to deliver on our guidance. GCC's guidance is for low- to mid-single digit growth in cement and ready-mix volumes whereas pricing will be mid- to high-single digit in both countries. On a consolidated basis, we expect EBITDA to increase between high-single to double digits against last year's levels.

With that, this concludes our prepared remarks. Let's now turn to your questions. Operator, please go ahead.

Operator

Our first question comes from the line of Adrian Huerta with JPMorgan. You may proceed with your question.

Adrián Huerta

Thank you. Hi, Luis Carlos and Enrique. Good morning. Two questions from my side, one on blended cement. In the previous quarter, you mentioned that you were targeting for the plant in Rapid City to have probably 11% of production in PLC cement by this yea,r I don't know if by the end of the year, and that you were doing some testing with customers for the Pueblo plant. Can you give us any updated targets on blended cement?

The second question is on electricity prices in Mexico. What were, for you, electricity prices on a year-on-year basis in the first quarter, and if you think that the prices could accelerate even further from where they were in this quarter? Thank you.

Enrique Escalante

Good morning, Adrian. Thank you for your questions. On blended cement, the update, I think we commented that the Trident cement plant in Montana, it's 100% turning to blended cement, basically PLC cement, this year. For Rapid City, we're starting with the market penetration on that plant. We had in the budget 100,000 tons for this year. We're looking optimistic that the market will project more volume, higher volumes than what we budgeted for.

At Pueblo, we have a late start in the budget for this year because we were making some repairs in our silos to be able to handle the two different products at the same time, the normal type II construction cement and now with the PLC cement. We're running on time on that project. We initially budgeted to start selling this product in November in this plant. Now we're thinking that the second semester, we're going to be ready to start earlier than we have said before. It's looking very well.

At the Tijeras plant, it's also selling blended cement, based on pozzolan, and it's also moving forward with a project there to increase our output of pozzolanic cement. Basically, the only plant that doesn't have any short-term plans yet is the Odessa cement plant, because precisely the distinctive quality of the oil well cement, that we're going to move a little bit slower there in tandem with the customers to make sure that any additions of limestone there are well-received by all the oil drilling companies.

Adrián Huerta

Just very quickly on blended cement, just to make it clear, on the Pueblo one, you said you were planning on starting to sell blended cement by November of this year, now second half of 2023, is that correct?

Enrique Escalante

No, second half of this year. We're running ahead of budget in our plans to start selling blended cement there.

Adrián Huerta

What percentage of that plant?

Enrique Escalante

I don't have a percentage at this moment because we're presently working on, based on this silo adequation, Adrian, how much we're going to be able to ship in the second half of this year, but we can update you on that in the following weeks.

Adrián Huerta

Thank you.

Enrique Escalante

On the electricity numbers, I don't have at this moment in front of me the specific increase of one of the plants in Mexico. I can tell you that it has been below our expected numbers, but we will also be able to give you the specific numbers in a follow-up call.

In terms of expectations, of course, as gas prices continue to rise in the international market, we're expecting that this would be a pass-through in costs in terms of power, mostly in every market. That will depend on the behavior of course of gas prices. Again, we don't have a specific number forecasted, since it would be based on that gas price volatility at the moment.

Adrián Huerta

Thank you, Enrique. Appreciate it.

Operator

Our next question comes from the line of Carlos Peyrelongue with Bank of America. You may proceed with your question.

Carlos Peyrelongue

Thank you for the call, Enrique and Luis Carlos. Two questions if I may, first one on pricing. You mentioned that you have announced a price increase for cement construction volumes in the U.S. of $8 per ton. Should we expect also in Mexico and in Texas for oil well cement, a second price increase in the second half of the year? Is that still something that is in the cards, considering cost pressures?

The second is related to volumes in Mexico. You reiterated your guidance that volumes are expected to grow both in Mexico and the U.S., and you mentioned that due to the inventory issues that clients built in Mexico and that volumes were down, but you don't expect that to continue in the next couple of quarters. Should we interpret from that that you're still expecting volumes to be positive for the year in Mexico? Thank you.

Enrique Escalante

Thank you for your questions, Carlos. Let me address the pricing question first.

As I mentioned, we already announced the $8 per share ton increase effective July 1, one month ahead of what we initially forecasted. We have already maintained conversations with the market, with the customers, advising them that this may not be the last price increase of the year. There is expectations that there could be another, in this case late year price increase, of course to keep adjusting based on inflation and market conditions. That's in the U.S.

In Mexico, we are basically, as we speak announcing a second price increase for this year. It's going to be obviously effective this second quarter. All the while, we have not discussed a second price increase yet with the market, but I don't discard the possibility of, again based on the activity of that industry and the demand/supply balance, having a second price increase in the second part of the year.

So, markets are very strong and there's a lot of cost inflation pressure, and one of the main focuses of our sales team is to look at every opportunity to increase prices. We, of course, try to protect the margins as best as possible.

In terms of cement volume in Mexico, yes, absolutely, the decrease in the first quarter, in the bagged cement market, we think it's a one-time event because of again the advantage that the customers took in trying to increase those inventories during the last quarter. But since inventories are running short everywhere, for them and for us, I don't think that there is going to be another opportunity for increasing inventories at the distribution network level.

Therefore, the volume in the market will increase in the second half compared to the first half, definitely in the bagged cement sector. We will also benefit from a price increase on that volume increase. So looking very positive at the rest of the year.

Carlos Peyrelongue

Understood. On the expansion of one million tons that you plan to do, when do you think we will have an announcement as to the location of that expansion?

Enrique Escalante

In the next conference call.

Carlos Peyrelongue

Excellent. Thank you so much, Enrique. I appreciate it.

Enrique Escalante

Thank you, Carlos.

Operator

Our next question comes from the line of Vanessa Quiroga with Credit Suisse. You may proceed with your question.

Vanessa Quiroga

Hi. Thank you for taking my question. I'm going to pick up on exactly the previous question from Carlos regarding the capacity expansion. The one million tons, is that the new project that you are going to take on, or does that include all of the expansions that you are planning across your portfolio? That's the first question.

The other one is just about volumes in the U.S. They were stronger in the quarter than what you are guiding for the full year. What can you tell us about what drove the strength in the first quarter, and if you think it's kind of non-recurring? Thank you.

Enrique Escalante

Thank you, Vanessa. Let me address… No, the one million ton, what you have said, it's basically a 1.1-million-ton line. That's in addition to the expansion that we are currently doing at the Samalayuca plant for another 200,000 tons. You would say that total expansion projects today amount to 1.3 million metric tons, between the two projects.

Now, going back to your second question on volumes in the U.S., I'm not sure I could understand the last part of the question. Can you repeat it for me please, Vanessa?

Vanessa Quiroga

That I think these results for the quarter in the U.S. in terms of volumes was stronger than expectations, and actually, your full year guidance is not as strong as what we saw in the first quarter. So, I'm wondering if there was something specific to the quarter that led to this volume growth in the U.S.?

Enrique Escalante

Okay, sorry. Now, I totally understand your question. Yes, definitely. It was the higher demand that we experienced for oil-well cement in the Permian Basin during the first quarter. That's where the additional growth in the quarter was coming from.

Vanessa Quiroga

Excellent. Thank you very much.

Operator

Our next question comes from the line of Alejandra Obregón with Morgan Stanley. You may proceed with your question.

Alejandra Obregón

Hi, good morning, GCC team. Thank you for the call and for taking my questions. I guess, I have two. The first one is related to energy as well. Can you remind us, just ballpark, how does your energy mix look like and how has that shifted during the first quarter and where do you see it going for year end, both in U.S. and Mexico, amidst this environment on costs?

Then the second question is related to you mentioned a second price increase for the second quarter in Mexico. Can you provide some color on the magnitude for that, and when do you expect to see that shifting and passing onto the shelves? Thank you very much.

Enrique Escalante

Alejandra, on your first question, energy mix, as a reminder, basically the Pueblo plant, the Tijeras plant in New Mexico, and the two cement plants in Mexico usually run 100% on coal. This has not been the case this last quarter because we have been burning some gas in some of these plants. The reason is that we are going from one section of the coal mine to a new section. We're building a project to move from one area to the other that is going to be ready by June of this year. When we start mining in the new section, we are going to be able to increase coal shipments from our mine to these five plants, reducing our consumption of natural gas, and then reducing our overall fuel cost. That is part of our cost containment and inflation containment actions on the fuel mix process. So, we are going to have a better mix based on more of our own coal, less gas, and less purchases of outside third-party coal that we were buying as a supplement during this construction project in our mine.

The rest of the plants, the Odessa plant runs 100% in gas, and we have some gas contracts that protect us from a price increase there. The Rapid City cement plant runs on third-party coal from the Permian Basin, where we also enjoy a long-term contract with stable prices. So, we have a very good hedge in terms of fuel cost in the Company, and we expect that to improve again in the second part of the year with the change in mix that we are planning to do here.

Now regarding the price increase in Mexico, the date first, it's going to be immediate. I'm talking effective no later than May. I don't have a definite number that I can give you at this moment. We're precisely as we speak finalizing those numbers, so we can announce that to the market no later than next week. We can give you information on that next week.

Alejandra Obregón

Understood. That was very clear. Thank you very much.

Operator

Our next question comes from the line of João Santos with UBS. You may proceed with your question.

João Santos

Hi, thanks for taking my question. Congrats on the results. My questions regard the top line during this quarter. We saw very strong figures for revenues, above historical levels for the first quarter. Since the first quarter, seasonality is weaker than the others. Was there any specific trigger that we should take into account, or can we expect the Company to maintain this performance in other years? Thank you.

Enrique Escalante

Thanks a lot for your question. I'm going to relay this question to Luis Carlos for him to give you more specific numbers.

Luis Carlos Arias

I understood your question ask if the same performance that we have in top line revenue is expected to be the same for the rest of the year, is that what you asked?

João Santos

Yes, it's more precisely in the first quarter, because when we seasonally adjust it for the total of the revenues in the year, we see the first quarter weaker than the others. My question is if there was a specific trigger for this first quarter in relation to previous first quarters?

Luis Carlos Arias

Well, yes. The trigger for this quarter, as Enrique explained, part of it is the strong performance of oil-well cement. What we expect for the full year is what we explained in terms of the guidance, which is low- to mid-single-digit in volumes, and mid- to high-single-digit in prices. Normally the first quarter has a lot of volatility because of the winter. It's not the big quarter in terms of the construction season, so it is not always a proxy for the performance of the rest of the year.

João Santos

Okay, thank you.

Luis Carlos Arias

Thank you.

Operator

Our next question comes from the line of Héctor Maya with Scotiabank. You may proceed with your question.

Héctor Maya

Hi. Thank you very much for taking the question.

It is to see if you could please share further details to understand the reasoning behind why you're maintaining your guidance because it seems to us that, it's a bit conservative, so we wanted to understand how you're thinking regarding the possible downturn in demand, or if it's a little bit more related to housing, or if it's more on the side of being conservative due to potential higher distribution costs. Thank you.

Enrique Escalante

Thanks a lot for your question. So, you're asking about the guidance, that if it's a little bit conservative based on the results of the first quarter. Was that the question?

Héctor Maya

Yes. One part, it's about the results of the first quarter but also trying to understand a little bit of what you mentioned when you talked about the guidance if you are possibly thinking about slower demand.

Enrique Escalante

Yes, okay, understood. We gave this guidance of course during the call of last quarter. We already had our budget, and we were already seeing the backlogs in the market and the dynamics of the market, so our supply and demand were based on those volume increases that are somehow capped by our total capacity at the moment. If there is more than—actually, there is more demand than what we can fulfill at this moment, as well as many other competitors in the U.S. A lot of customers are already on allocation given the limitations of the industry to supply more cement at the level that the demand is.

That's why our guidance in terms of volumes is somehow capped at those levels. There could be potential to improve the guidance based on the pricing information that has been recently developed. However, since we are also fighting these inflationary cost pressures, we're maintaining the guidance at the level that we communicated it during the last quarter of the year.

So yes, there could be some upside potential based on pricing, but we will prefer to remain a little bit cautiously optimistic and not go overboard here.

Héctor Maya

Thanks for that. Very clear. Thank you.

Operator

Our next question comes from the line of Alejandro Azar with GBM. You may proceed with your question.

Alejandro Azar

Morning, Luis Carlos, Enrique. Just a quick one on your Capex. Are you seeing a delay in the deployment of it, or are you still thinking of spending those $260 million for the year? If that's the case, should we think that most of those will be seen in the second half of the year? Thank you.

Enrique Escalante

Yes, let me address the first part of your question and then I will ask Luis Carlos to complement.

The Capex for the year divided basically in two segments; $80 million are basically the maintenance Capex for the year, plus the carryover that we're bringing from 2021. That's been spent on pace. We don't see a delay in the deployment of all the maintenance Capex.

In terms of the projects, the Samalayuca project, it's of course running on schedule too, so part of that Capex on the growth projects is going to be also deployed as forecast. The rest of the Capex, the part that corresponds to the other projects may be delayed a little bit during the second half of the year because we're still working hard with the technology suppliers and the contractors, given the inflationary environment and the delays in the supply chain. So, there may be a delay in how we deploy part of that Capex.

But I will ask Luis Carlos to give you more color on that second aspect or section of the Capex.

Luis Carlos Arias

Sure, Enrique and hi, Alejandro. Yes, definitely, most of it is going to be spent on the second half. As Enrique is explaining, we may see part of that growth Capex going into the first quarter of 2023, as we're talking with the vendor, with the technology providers who are making all the necessary work to have more clarity on how we're going to deploy this Capex. Definitely, it's going to be more in the second half of the year, and some of it going into the first quarter of 2023.

Alejandro Azar

Thank you both. Just one quick more, Luis Carlos, if you could remind us, the volumes from the Samalayuca expansions, when do you see them, or the ramp-up of that expansion, and also the ramp-up of the new plant?

Luis Carlos Arias

Yes, Alejandro. Well, the volumes coming from the Samalayuca are definitely going to be in 2023, in the first half. We're going to have the first output from that expansion. As we said on the other project, we want to finish that project in 2024, so we may have part of that output of production in late 2024.

Alejandro Azar

Thank you, Luis Carlos and Enrique.

Luis Carlos Arias

Sure, Alejandro.

Operator

Ladies and gentlemen, we have reached the end of today's question-and-answer session. I would like to turn this call back over to Mr. Ricardo Martinez.

Ricardo Martínez

Once again, thank you to everyone for your interest in GCC and for joining us today. We appreciate your questions this morning and look forward to talking with you again in the months ahead. This concludes our conference call, but our team is of course available for any follow-up question you may have. Goodbye and stay safe.

Operator

You may disconnect your lines at this time. Thank you for your participation and enjoy the rest of your day.