CORPORATE PARTICIPANTS

Ricardo Martinez, Head of Investor Relations

Enrique Escalante, Chief Executive Officer

Luis Carlos Arias, Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

Mauricio Serna, UBS

Francisco Suarez, Scotiabank

PRESENTATION

Operator

Good morning and welcome to the GCC third Quarter 2019 Earnings Call. 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 that starting this quarter, a slide presentation will accompany GCC's earnings results webcast, is available on the company's website at www.gcc.com, within the Investor section Also note that there will again be an opportunity for you to ask questions at the end of today's presentation and that this call is being recorded.

At this time, I would like to turn the call over to Ricardo Martinez, Head of Investor Relations. Please go ahead.

Ricardo Martinez

Thank you, operator. Good morning everyone and thank you for joining our earnings call. With me on today's call are Mr. Enrique Escalante, our Chief Executive Officer and Luis Carlos Arias, our CFO.

Turning to slide two, please note that management will make forward-looking statements that are based on our current expectations, forecasts and assumptions, and involve risks and uncertainties. These statements include but are not limited to statements regarding the future performance of GCC, including expected financial results for the fourth quarter and full-year twenty nineteen, as well as the future growth of our business. Our actual results may vary materially from those discussed in this call. 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.

With that, let me now turn the call over to Mr. Enrique Escalante, Chief Executive Officer. Please go ahead Enrique.

Enrique Escalante

Thank you, Ricardo, and good morning everyone.

On slide three, as you have read in our press release, we delivered strong operational results for the third quarter twenty nineteen, posting solid top line growth while increasing sales by more than eight percent for the quarter and just over four percent year to date despite a particularly difficult start to the year. As was reported in our quarterly results released yesterday, improved weather in the third quarter enabled us to trigger our strong backlog, resulting in the strengthened volumes we had anticipated while we benefited from improved pricing in both markets, however lower than we had expected, particularly in GCC's U.S. cement business. So let me now take this opportunity to provide a more detailed review of our main drivers of our business during the quarter in those markets in which we participate. Luis Carlos will then share more color on our financial results and he'll then turn the call back to me for comments regarding full year guidance and closing remarks.

Turning to slide four, as I had commented, we are pleased with the results we achieved this quarter, particularly in the U.S. where we saw very strong shipments across all of our states to reach record high cement volumes for GCC.

Following an extraordinary winter and rainy season which hindered construction activity during the first half of the year, improved weather during the third quarter enabled us to capitalize on pent-up demand, on the back of our robust distribution network and operational capabilities.

Despite the impact of labor shortages affecting the construction industry throughout most of the regions in which we operate, we expect this robust performance to continue in the fourth quarter assuming favorable weather conditions continue.

Our strong topline performance enabled us to deliver fifteen point two percent of EBITDA growth with almost two hundred basis points of margin expansion.
Let me now turn to the key performance drivers in the U.S., starting in the South and moving North. I will then review GCC's Mexico operations.

On slide five, In El Paso, Texas, infrastructure works continue to be the main growth driver with no further delays at our main projects.

Regarding the Permian Basin oilfields in West Texas, cement consumption demand and shipments remain strong despite several challenges that the oil industry has faced. Further, as we have noted on previous calls, we continue to see a very competitive environment in this area, as oil well service companies remain focused on cost reduction across the supply chain while they identify new ways to innovate to increase their profitability and cash flow generation. In light of this, we have made the decision to adjust our pricing strategy accordingly in order to defend our market share as we continue to build long term relationships with our customers. We therefore do not expect to implement any price increases until the first quarter of twenty twenty.

On a positive note, said cost reductions have resulted in layoffs across the Permian Basin with shale producers turning to workforce cuts as investors step up demands for returns; easing the shortage of skilled workers in this region and expanding our accessible labor pool of permanent maintenance employees with no further need to turn to more expensive outside contractors.

In terms of pricing for twenty twenty, we have announced, an additional eight U.S. dollar per metric ton price increase that will come into effect across all our markets on April first, in line with the industry. Looking ahead, given the current tight supply and demand dynamics, as well as the high utilization levels in the cement industry and assuming favorable weather conditions, we expect to experience much less pushback than what we have been seeing this and previous years.

In Colorado, we continue to see a strong performance, underpinned by solid demand from housing and public infrastructure construction.

Turning to the northern Midwest and Plains states: the windfarm construction sector in the Dakotas and Iowa was again a strong driver for demand in the quarter. During the first half of the year, we experienced some weather-related delays which have pushed some projects to next year, but we are confident this segment will continue to gain traction within our company, particularly in twenty twenty, due to our strong windfarm backlog.

In North Dakota, we are seeing more activity from oil well cement produced at our Rapid City plant, as volumes shipped to the Bakken oil fields have been increasing, enabling us to capture additional demand from our customers all the way from North Dakota to Colorado.

In Montana, we continue to leverage GCC's new Trident plant to consolidate and sell directly to our Canadian customers while we address the increased sales we are seeing in both Montana and Idaho.

To briefly touch upon our Rapid City facility stabilization process: this plant is now running well, having achieved near optimum levels. The two main issues that we faced during the first half of this year related to certain auxiliary equipment are now under control, one of which has been fully resolved. Regarding the conveyor belt, temporary modifications have been made and we expect to have this fully resolved during first quarter of next year.

Turning to our Mexico operations on slide six, we again delivered strong third quarter results on the back of both price and volume growth in an increasingly competitive environment, however, we have successfully defended our market share within this region. Market dynamics remain similar to our prior quarters, as the Chihuahua region continues to outperform the country as a whole, benefitting from the positive sentiment towards the enforcement of the new free trade agreement. Sales volumes are still being driven by industrial maquiladora plants, warehouse construction and mining projects. In the northern cities, the middle-income housing segment also showed strong demand.

Let me now turn the call over to Luis Carlos to review the quarter's financial results and I'll return for some closing comments.

Luis Carlos Arias

Thank you, Enrique, and good morning to everyone. Let me begin by reminding you that results for the Trident plant in Montana were consolidated effective July first, twenty eighteen, so the third quarters of twenty eighteen and nineteen are now both comparable. Our results for two thousand and eighteen also reflect the reclassification of the Oklahoma and Arkansas ready-mix assets sold in June last year as discontinued operations and in accordance with IFRS-five sales, costs, expenses and volumes have been restated

Turning to slide eight, Consolidated net sales for the third quarter increased by eight point three percent. This was mainly driven by the increase in cement and concrete volumes, in the US and Mexico, and better prices in both countries.

In the U.S., we achieved a nine point eight percentage points increase in cement volumes, reaching an all-time high for our company as Enrique had commented. Mexico continues to perform above our expectations with sales growing five point five percent year on year boosted by growth in volumes, partially offset by the depreciation of the Mexican peso against the U.S. dollar during the quarter.

On slide 9, Cost of sales as a percentage of revenues remained stable at sixty nine point six percent compared to sixty nine point seven percent in the prior year quarter. Increases in variable costs, operating and logistics expenses were offset by favorable pricing and lower depreciation. All of this was achieved while ensuring customer service remained as our top priority, as we have absorbed significant increases in distribution expenses resulting from re-routing shipments to ensure uninterrupted service to our valued customers

In Mexico we continue to see pressures on energy costs, but, as we had previously mentioned, we are working on alternatives in the form of renewable energy through the use of new long-term electricity generators which should drive significant future cost savings, while we continue identifying other solar energy options for our cement operations, either through third parties or on-site.

Regarding fuel, we reiterate our commitment to increasing the usage of alternative fuels whenever possible at all GCC cement plants in order to achieve between twenty to forty five percent substitution rates in the mid-term.

Selling, general and administrative expenses as a percentage of sales remained stable at seven point three percent benefitting from the growth in our topline.

Turning to slide 10, EBITDA increased fifteen point two percent in the third quarter, with a one point nine percentage point margin expansion, to thirty one point nine percent. On a comparable basis, excluding the IFRS sixteen effect, EBITDA increased eight point six percent in this quarter.

As we mentioned on our previous call, EBITDA this year and hereafter will benefit from the implementation of IFRS sixteen due to the fact that the majority of the former rental expenses from operating leases is now reflected in amortization increasing this year´s EBITDA around twenty million dollars, neither impacting net income nor free cash flow.

On slide eleven, Net financial expenses fell five point nine percent in the quarter mainly due to an increase in financial income resulting from our higher cash balance, and a positive variance in our FX line due to the depreciation of Mexican peso relative to the U.S. dollar.

Income tax decreased three point eight percent year on year to twelve point four million dollars in the third quarter of twenty nineteen.

As a result of these factors, and with benefit of strong operating results, income from continuing operations increased twelve point eight percent to forty eight point seven million dollars while earnings per share increased thirteen point eight percent in this quarter.

Moving to our cash generation on slide twelve, free cash flow increased eighteen point nine percent to ninety point six million dollars in this quarter, translating into a free cash flow conversion rate of approximately ninety-four percent. This strong cash flow generation was driven by increased EBITDA generation after operating leases, lower cash interest expenses, higher non-cash accruals and a decrease in maintenance capex. Higher cash taxes and lower working capital generation partially offset this increase.

As a result, we remain focused on strengthening our balance sheet ensuring the flexibility to capture future growth opportunities, which we continue to assess on an ongoing basis. In this sense, our capital allocation strategy remains unchanged, always seeking to improve our returns and deliver strong stakeholder value while investing in our business to capture organic and inorganic growth. Our dividend distributions also remain in place, and have increased consistent with our historical rate.

Along these lines, as we anticipated on our previous call, on August fifteen we made a dividend payment of zero point eight Mexican pesos per share. This represents a fifteen percent increase compared to last year's dividend payment- all while maintaining an efficient capital structure. Our net debt to EBITDA advantage ratio decreased from one point eight in June twenty nineteen to one point five times as of September twenty nineteen, significantly below industry average level.

With that, I will now return the call over to Enrique to discuss the new guidance and for his closing remarks.

Enrique Escalante

Thank you, Luis Carlos,

Turning to slide thirteen while the underlying trends of GCC's business remain solid, and despite the strong cement shipments that we saw in this quarter, we are revising our guidance for the full year.

In terms of US ready mix and cement volumes, our guidance remains unchanged. As a reminder, we expect total cement volumes in the U.S. to increase three to five percent year over year with a one to three percentage increase on a like to like basis, We are expecting volumes at our ready-mix business to remain flat for the balance of twenty nineteen, This is due to the substantial volumes we had previously expected during twenty nineteen which were pushed forward into the twenty twenty period.

In terms of cement pricing in this market, we are reducing our guidance to between two and three percent, from four to five percent, while ready mix prices remain unchanged.

Turning to Mexico, we now expect to grow between one to three percent from flat volumes in both cement and ready mix while pricing is expected to remain unchanged.

Regarding profitability, the incremental logistics costs we faced during the first half of the year combined with the challenging pricing environment in the US have directly impacted our bottom line, Therefore, we now expect EBITDA to grow between eight to ten percent year over year, versus our prior guidance of between fifteen to seventeen percent, and between zero to two on an adjusted basis excluding the IFRS sixteen accounting impact- adjusted from the seven to nine percent which we previously expected.

Our estimates for total capital expenditures decreased from seventy to sixty five million dollars and we expect free cash flow conversion and net debt to EBITDA guidance to remain unchanged.
We continue to expect to finish the year with a free cash flow conversion rate above forty percent and a net debt to EBITDA ratio around one point one times.

Looking ahead, while we faced a challenging operating environment mainly due to adverse weather conditions particularly in the first half of the year, I would like to reiterate our commitment to our shareholders. With our strong balance sheet, state of the art production facilities and our customer centric flexible distribution network, combined with our continued efforts to streamline our cost structure without giving up growth, we are confident that we are in the right path to continue delivering strong long-term value.

Finally, also related to our Sustainability efforts on slide fourteen, in September of this year we signed a long-term agreement with a leading U.S. based energy provider to supply solar and wind power to GCC's Odessa, Texas cement plant, covering 100% of the electricity consumed at these operations.

This ten-year fixed-price agreement will begin on July twenty twenty two and represents approximately a twenty two percent decrease from the current electricity price for the Odessa plant, translating into approximately four point six million dollars in total savings for this period

This will result in approximately forty five thousand metric ton reduction in CO_2 per year which is equivalent to around nine point five thousand passenger vehicles driven for a year, based on the U.S. Environmental Protection Agency estimate.

The above is another example of our unwavering commitment to implementing global best practices related to sustainability throughout the organization while further strengthening the Company's overall profitability

With that, this concludes our prepared remarks and we are now ready to take your questions.
Operator, please go ahead.

Operator

Thank you, sir, and ladies and gentlemen, if you do have any questions, please signal and join the queue by pressing star, one on your telephone keypad, and we do ask that you limit yourself to one question at a time for clarity's sake. Again, ladies and gentlemen, star, one for any questions at this time.

First, from UBS, we have Mauricio Serna.

Mauricio Serna

Yes. Hi. Good morning. Thanks for taking my question.

Just going back to the U.S. operations, the Company did deliver some strong margin expansion despite the cost headwind, so just was wondering if you could maybe provide a little bit more details on how we should be this—we should see this cost, I guess, fading throughout this quarter, and probably at the beginning of 2020, specifically on the issues regarding the ramp-up of the Rapid City expansion, and you did mention that the issues with the equipment were solved, but, I mean, about how much of a headwind should we expect from the conveyor belt, which I think you mentioned was still something that should continue (inaudible) in the second half of the year, and also specifically on other things like the sourcing of coal, and yes, those two mainly—those two main issues.

Enrique Escalante

Mauricio, thank you very much for your question. This is Enrique. Luis Carlos is going to, I mean, try to give you some more details on the numbers you're asking for, but let me go to your final questions first about the ramp-up of the Rapid City plant.

What we're planning to do, and we're almost in agreement now with all the team and the (inaudible) is to install a new conveyer belt which is more robust than the one that we have is going to be continued engineer, and it's at the cost of the (inaudible) Company, so the only cost that we have to, I mean, face here is the installation cost, which is not significantly material, so that shouldn't have an impact on the performance on the growth side of next year.

In terms of sourcing of coal, no, that was only the first half of the year, given that one of the issues that we faced would be coal (inaudible) where we were mining. As you may remember, we've changed that, and mine—the mine is running well, and we don't expect to have any further delays to continue for the (inaudible) of the quarter within our plant without having to buy anything external, so coal—I mean, cost should remain in line with what we, I mean, expected, I mean, for the second part of this year.

Luis Carlos Arias

In regards to first part of the question, Mauricio, look, as we have explained in this call and the last quarter's call, the challenges—the main challenges were the tons of freight and the challenges of the Rapid City plant, as Enrique's explaining, and I called out we have to purchase from third parties. We don't foresee those challenges to be as hard going forward. We don't see, again, purchasing coal from a third party, or a lot of challenges on the tons of freight part, what—but we have to take into account that the fourth quarter is—the fourth quarter volumes are less than the third quarter in the U.S., so operating leverage is not as strong as the third quarter. That's one of the main factors.

Mauricio Serna

Got it. Thanks very much. Maybe just a couple of follow-ups. In the sense of cost and energy, specifically, would seem, I guess, the Mexico margins continue to compress a lot, despite the strong volumes. Would expect, maybe, the Company seeing this strong volume dynamics, could it increase prices a little bit more to offset this pressure, or how are the initiatives moving along in terms to improve or bring back the margins a little bit more in the Mexico operations, and also, just following up, if you have any updates regarding any strategic capital deployment initiatives going forward? Thank you.

Enrique Escalante

On your first question, in Mexico margins, Mauricio, definitely we are planning to increase prices in the near future in Mexico to offset, I mean, the inflations costs that we are observing mostly (inaudible) electricity costs. In our specific case, I mean, the fuel cost is going to be a constant—I mean, stable because of the reasons I just gave about the mine, and so we're working with the team now, I mean, to announce a price increase shortly for the Mexican market. On the cost structure for Mexico, as we have explained in the past, we're working on electricity solar sources on a long-term basis, and, of course, we are trying to increase the usage of our (inaudible) fuels going forward.

Mauricio Serna

Thank you very much, and the other thing regarding the strategic deployment of capital?

Enrique Escalante

We don't have anything specific at this moment, Mauricio. We keep working (inaudible) permanently and looking for inorganic growth opportunities, and as soon as we have something solid, we'll communicate it to the market.

Mauricio Serna

Got it. Thank you, and congratulations on the results.

Enrique Escalante

Thank you, Mauricio.

Operator

Ladies and gentlemen, one more reminder, that is star, one if you have any questions; star, one to join the queue, and just again, we do ask that you limit yourself to one question at a time. Once again, ladies and gentlemen, star, one if you do have any questions. We'll pause for just a moment.

Moving on, we have Francisco Suarez with Scotiabank.

Francisco Suarez

Hi gents. Good morning. Thanks for the call, and just to understand a little bit more on what you are seeing in the Permian region, I think that the overall environment for drillers is challenging. I understand the dynamics in Texas and elsewhere on those regions are quite solid. They are in sold-out markets. Nevertheless, what do you think might change next year in order to see better prices ahead? I mean, do you see overall tighter market conditions in your key markets, and just if I may, what about the existence of the utilization rates that you have at Rapid City if you can share that with us. Thank you.

Enrique Escalante

Francisco, thank you very much for your questions.

Let me address the Permian Basin first. As we comment on our reports today, yes, we're experiencing, I mean, a competitive market in the Permian Basin, and even though demand is strong in Texas, the pressure is coming, basically, from Wall Street, I mean, to these oil service companies where they're expecting them now to improve the profitability and improve their cash flow generations, and we see some of the smaller drillers, I mean, be in a difficult situation, and those—some of those, I mean, could probably be absorbed by larger and oil well service companies, and that's what we expect to see, and that will bring customer stability to that market during 2020, but we are, I mean, attentive to that, and, of course being, I mean, careful with our receivables from those—some of those smaller companies, but everything's going well so far.

There has been conversations already with our customers in terms of the overall price increase, and it's going to move forward. It's been announced at (inaudible). We missed, I mean, the opportunity to increase the pricing October of this year, which was what we—we had it planned, but with all that background, I mean, and the discussions with the customers, it seems there's going to be no problem to increase, I mean, the price in the first quarter of next year, so we're seeing a strong, robust demand, and with this expectation of better margins for the rest of 2020 in that market.

Francisco Suarez

Okay. Thank you.

Enrique Escalante

I will turn the question now to Luis Carlos for the Rapid City plant.

Luis Carlos Arias

Yes. Can you clarify the question about the Rapid City utilization?

Francisco Suarez

Yes. I was just wondering what is the current rate on utilization on your new install capacity on that plant?

Luis Carlos Arias

Well, we're actually, as Enrique explained in his remarks, we have solved most of the issues in terms of having a smooth utilization of the plant. We've operated in the 70s in the last month, so it's all a matter of solving the last parts of the challenges that we experience.

Francisco Suarez

Perfect. Thank you so much.

Operator

Once more, ladies and gentlemen, that's star, one for any questions; star, one to join the queue.

All right, and it does appear that we have no further questions from the audience. At this time, I'd like to turn the floor over to Enrique Escalante for any additional remarks.

Enrique Escalante

Thank you for joining us today, we appreciate your interest in our company. We look forward to meeting more of you over the coming months and providing relevant updates. In the meantime, our team remains available to answer any questions that you may have. Thank you and enjoy the rest of your day.

Operator

Once again, ladies and gentlemen, that does conclude our call. Thank you for joining us. You may now disconnect.