MEPCO Q4 23A conference call

Sunday, April 7, 2024

Nour Eldin Sherif Good morning and good afternoon, ladies and gentlemen, and thank you for joining us today. This is Nour Eldin Sherif and on behalf of Arqaam Capital I'm delighted to welcome you to MEPCO's fourth quarter results conference call. I have with me here today Mr Sami Al Safran, Group President, Mr Amr Masry, Group CFO, Mr Ahmed El Fazary, Group CCO, and Mr Mohamed Elsherief, Waste Strategy Director. With no further delay, I will turn over the call to Mr Masry.

Amr Masry Good morning and good afternoon, everyone. Welcome to MEPCO 2023 earning release call. We start with a disclaimer. This presentation is prepared by MEPCO and contains basic information about company activity as the latest published results. The information is presented in summary, rather than detailed form. This information, including any forward-looking statements, should not be taken as basis for investment recommendation, solicitation for any of the company's tradeable securities.

While management has made every effort to present a fair view of MEPCO's operational and financial performance in this presentation, it is important to note that the expectations about the future results that come in light of prevailing operational, financial and market conditions may change in the future. Management does not recommend using such forward-looking statements and financial modelling or investment decision making, thus takes no liability to explain the difference between future actual results and what was stated in the course of this presentation.

The presenters and the attendees of the call will be Mr Sami Al Safran, Group President, myself, the Group CFO, and Ahmed El Fazary, the Chief Commercial Officer of the group. We also have with us, not included in this presentation, Mr Mohamed Elsherief, the Director of the Waste Strategy.

We will start by going through our key performance indicator. We'll give you a market overview and then we'll deep dive into the containerboard market and the tissue market. I will give you a brief overview of our local and international sales in both containerboard and tissues, and then the financial review. Finally, we'll close with the management outlook.

For the main key performance indicators, the company for the year 2023 achieved a total of 867 million total revenues. That is a drop of 27% versus same period for last year. Our gross profit margins remain positive at 85 million, although this has dropped by 83% versus 2022. EBITDA also remained positive at 52 million, dropping 87% versus the previous year. Net losses to the parent are 80 million with a drop of 130% versus the year before. And our cost of sales are 782 million, increased by 14%. Gross profit margin, we have achieved 10%. This is 3,255 basis points lower than the year before. EBITDA margin is at 6%, that is 2,810 basis points lower than 2022. And our net income are negative 9%. This is 3,198 basis points lower than the previous year.

In general, for Saudi, we're looking at real GDP. Saudi's total real GDP for 2023 is expected to reduce 0.8%. This is mainly driven by a 9% reduction in the oil activities, while the non-oil activities are still growing at a rate of 4.4% and government activities are growing at a rate of 2%. According to the World Bank estimate, the worldwide economy is expected to grow at 2.4% in 2024 while most of the emerging market, excluding China, will be growing at 2.9% in 2023 versus 3.1% in 2022.

For the containerboard industry, world containerboard demand is currently estimated at 188 million tonne. The MENA region is estimated at 3.4 million tonne and Saudi Arabia demand is expected at 1.2 million tonne. Looking forward, the growth in the containerboard demand is expected to be at 4.2% in 2024 and growing by around 3 to 4% for the next three to four years. MEPCO's current market share in Saudi remains at 30% for the year 2023 and the demand in Saudi is expected to grow at 4.1% for the recycled containerboard and 6.7% for the virgin containerboard.

For international price benchmarking we have presented the two major markets that we compare to. One is the Italian test liner. Test liner is one of the products that MEPCO sells and the OCC, which is the main raw material that we use. For the Italian test liner for the year 2023, the test liner has ended the year at an average price of 450. And the average price for OCC for the last quarter increased from $76 in Q3 to $107 in Q4 2023.

The GCC Price Index, which has been recently published for the test liner, shows after a drop in the third quarter where prices have reached up $405, shows an increase and enhancement in price in December and is expected to increase further in the year 2024.

For the tissue market, the global tissue consumption is at 44 million tonnes. Saudi's consumption is about 250,000 to 300,000 tonnes, while average global demand is still healthy and is still showing a growth at 3.2% globally. Saudi remains above the international average, with about 3.5% growth. We do expect to generate positive income for the year 2024 in JUTHOR, while we continue to grow our market share. We anticipate a gross profit margin by end of 2024 between 23 and 25% for the company. Growth in tissue demand for the next year globally is expected to be around 2.3%.

We have benchmarked the tissue prices against the pulp prices. We have particularly used one benchmark, which is the Chinese pulp hard wood, to give an indication about the price of pulp. The price of pulp is an indicator of the price of tissue, should be used as an indicator only of the price of tissue. Price of pulp had increased during the year 2023. They recovered from a $596 per tonne in the year 2022, recovered to around $643 at the end of the year 2024. Pulp reflects 60% of our total cost of sales in the tissue industry.

In terms of our sales in local markets and exports, quarter-on-quarter for the volumes in export we have seen a drop of 20%, while we have seen a 7% increase in our local sales. Year-on-year we still maintained in both exports and local volumes a growth of 9%. In terms of values, we had a significant drop in our sale value, mainly driven by drops in sale prices in the containerboard industry. For JUTHOR, at the close of the year 2023, the tissue currently constitutes 10% of our total revenue, and the utilisation rate for the company reached 65%. We have managed to achieve a total of SAR90 million in revenue during the year 2023 in the tissue industry.

For the containerboard, in particular, we still maintain the same average, with a slight drop between export and local sales. Export sales have reduced slightly during the last quarter to 57%, versus a drop of 33% in the local sales.

For the key financial reviews, Q2 has seen a 2% drop versus Q3. Our revenues dropped from 229 to 224. This drop is mainly driven by a small drop in our quantities for this period, due to a planned shutdown that we had during the end of the year for maintenance. Year-on-year our sales dropped from 1.1 billion to 867 million. This drop is mainly driven by 33% decrease in our average sale price versus last year. The gross profit margins have also been reducing during the year 2023. Our gross profit margins reduced from 16% in Q1 to 10% in Q3 and we closed the year in Q4 at a gross profit margin of 1%. The drop in gross profit margin versus last year is 83%, our gross profit margins dropped from 42% or 503 million in the year 2022 to 10% and 85 million in the year 2023.

In terms of our cost of sales breakdown, the fiber cost still stands at 44% of our total cost of sales. Other variable costs increased from 20% to 25%, as a percentage, and our fixed costs dropped from 37% to 29%. Overall, year-on-year we can see an increase in our cost of sales from 684 million to 782 million. This increase is mainly driven by the ramp up in sales volume in JUTHOR. The cost of sales in JUTHOR achieved around 90 million for the year 2023. We do note that there was a decrease in the price of OCC by 22% year-on-year, but the increase in the cost of sales is mainly driven by the increase in quantities in JUTHOR.

For EBITDA and the EBITDA margins, EBITDA has recorded a negative 2 million for Q4 versus 16 million positive in Q3. The margins have dropped from 7% to minus 1% in Q4 for EBITDA. Year-on-year our EBITDA margins dropped from 34% to 6%. Net income, last quarter the company had recorded the highest losses with 36 million total loss for the quarter. This is 16% versus an 8% and an 18 million loss in Q3 2023. Year-on-year we have a drop from 270 million profit in 2022, that is 23% positive margin, to a negative 9% net income margin and a total of negative 80 million.

In terms of the indicators between Q4 and Q3 2023, G&A has decreased mainly due to reversal of the penalties for the case that was raised against one of the company's subsidiaries and due to enhancement in our collection cycle, a reversal of the impairment provision of 5 million has been recorded in Q4. Finance charges also for the quarter have reduced for the last quarter and sale prices have shown a slight increase of 2% versus the previous quarter. Unfavourable changes for our key financial indicators between Q4 23 and Q3 23.

The decline in our total revenue, driven by the decline in our sales volume of 4%, due to the planned maintenance during the last quarter of the year and increase in our cost of sales by 8%, mainly due to maintenance and energy costs. Selling and distribution also have seen a slight increase and other losses have been recorded of 2.6 million, mainly due to impairment on some of the unused PPE assets.

Year versus year between 23 and 22, our key financial indicators. The favourable changes in our key financial indicators, we have recorded a 28% decrease in our transportation costs. G&A have dropped by 4% and impairment reversals have been recorded due to enhancement of sales collections from customers. In terms of the unfavourable key financial indicators between the year 22 and 23, definitely the sales price with 33% decrease is one of the major unfavourable indicators for the year. Increase in our cost is another unfavourable indictor. This is mainly driven by adding around 40,000 tonnes in both tissues and containerboard.

Finance charges also unfavourably impacted the group, mainly driven by the increase in CIBOR rates in [inaudible 00:20:34]. In terms of working capital, the working capital has dropped between 2022 and 2023, from 2.8 times to 1.3 times. And the overall working capital dropped 67% from 529 to 173. This drop is mainly driven by outflows from operations that dropped from 239 million to 199 million. That is a drop of 17% year-on-year.

Our debt to equity has increased from 0.34 in 2022 to 0.49 in the year 2023. This increase is mainly driven by the loss recorded in the year 2023. EBITDA to debt has increased from 1 to 10. This increase is driven by the reduction that has been recorded in EBITDA during the year 2023.

In terms of our mid-term and long-term outlook, the MEPCO management is still abiding by its growth strategy, increasing its sale and its production quantity in JUTHOR, to achieve the full capacity by end of Q1, early Q2 2024. Continue increasing JUTHOR's market share and cost management, to control the inflation of the economy. We're also committed to our growth plan strategy that has been announced in the latest prospectus, to double our capacity in containerboard and in tissues and look for the M&A transaction for forward integration. Thank you.

Nour Eldin Sherif Thank you very much, Amr, for the presentation. Now we can turn to the Q&A session. If you have a question, please raise your hand or submit your question in the Q&A box. We have our first question from Salman. Please go ahead.

Salman Al Hagbani Good afternoon, everyone. This is Salman Al Hagbani from Al Rajhi Capital. My first question regarding the energy cost. We have seen that the energy cost has increased by 75% year-over-year. Can you elaborate, how much of that increase is related to the tissue segment? And can you shed some light on that increase? Thank you very much.

Amr Masry Yes, the increase in energy cost is mainly driven by the increase in energy cost in JUTHOR. Currently, the energy cost in JUTHOR is higher than what was planned, due to the use of generators and diesel. The plant is expected to run on natural gas, but the natural gas lines have not yet been connected between the provider and the agent and the factory is currently running fully on fuel. Our costs are five times higher per ton than what it is supposed to be if natural gas is connected.

Salman Al Hagbani And do you have any expected time to have natural gas on your energy generation?

Amr Masry We expect this to be finalised during Q2. We have been requested to prepare our plans and get it ready to receive the natural gas. This is the latest announcement during the end of last month, so we do hope that in Q2 this problem will be solved.

Salman Al Hagbani That's all from my side. Thank you.

Nour Eldin Sherif Just as a reminder, if you have a question please raise your hand or submit it to the Q&A box. We have our next question from Abdul Rahman [inaudible 00:26:38]. Please go ahead.

Abdul Rahman Good afternoon and thank you for hosting this call. I just had a question on JUTHOR. How do you currently see the market dynamics in terms of demand, pricing? You mentioned that when pulp prices increase you're able to push the cost increase onto consumers. Could you just shed some light on the dynamics and the ability for the market to absorb the cost impact?

Ahmed El Fazary Abdul Rahman, hello everyone. Talking about global market, pulp prices have reached to their bottom prices by mid-2023, then they started increasing throughout the year. The significant increase in pulp prices was evident from October onwards and remains quite solid, the pulp prices. Tissue, as a byproduct of the pulp is highly correlated and globally tissue paper prices have been linearly going up with the pulp prices.

Talking about JUTHOR, we were successful in passing the price increases. We've announced a few price increases in the past period to reflect the increase in pulp prices. Just to give you an idea about the magnitude of the increase in raw material prices, and accordingly finished goods, it was in the range of $200 since it bottomed down in May 2023. This is in terms of prices and linkage between the raw material.

In terms of demand in Saudi Arabia, it's been quite healthy. We were anticipating that it would have slowed down after the holy month of Ramadan started, but the demand seems to be continuing and the picture is quite bright in terms of tissue.

Abdul Rahman Could you shed some light on which countries do you procure your pulp from? You mentioned in your presentation that the benchmark is China. Do you precure them from maybe Latin America or Europe, or could you shed some light on the countries of origin?

Ahmed El Fazary We procure the pulp from all different origins, but the most famous organs for the pulp is basically Latin America, specifically Brazil, Ecuador, a few others, Bolivia, and the Scandinavian countries. It depends because there's eucalyptus or the hard woods, the short fibres and the long fibres, the northern bleached, and mostly it comes from Scandinavia. So, that's predominantly it. We of course source from other regions, as well. Indonesia sometimes, but predominantly Latin America and [Inaudible 00:30:14]. When we look at the prices when we benchmark against China prices, because this is usually the benchmark for contracting, with adjustments of prices considering the freight differences.

Abdul Rahman I see. That's very clear, thank you.

Nour Eldin Sherif As a reminder again, if you have a question please raise your hand or submit your question in the Q&A box. Just until we have our next question, if I may ask a couple of ones here, mainly on the outlook of the containerboard prices. I think Q1 seems to see some recovery, is this sustainable? On OCC prices, especially in the local markets, as we understand is that we have seen in 2023 permissions for exports. Is this now more contained and do you think we could see international compared to local prices aligning anytime soon?

Ahmed El Fazary I'll take the outlook part on the containerboard, then I'll hand over the mic to my colleague, Mohamed Elsherief, to tackle the OCC raw material part. Looking back at the performance of the containerboard the past couple of years, 2022 and 2023, they were tough years in terms of demand. There was a drop overall by 7 million tonnes. The major drop was in the second half of 2022, then it continued in 2023, when the drop was by about 1.1% globally. It varied drastically from one economy or one market to another, but overall the drop was 1.1.

It's forecasted that in 2024 there would be a rebound in demand by 3.2%. Of course we do not expect a very strong rebound to see performance like the year 2021, but we expect an increase. With [inaudible 00:33:12] in our forecast we're positive, but we're carefully positive. In the region here, we were able also to announce a price increase that was supported mainly by healthy demand in the local market and in the region, opposed to other markets that were lagging behind in terms of demand performance. We believe that the majority of the destocking activities are almost done, which took place all over 2023.

The indications for Q1 are quite positive. Just to share some official data, to give the audience here a hint of the improvement that we see in terms of demand and accordingly reflected in prices. The GCC PIX Index has reflected an improvement of about $35 to $40 in Q1, so it's looking positive. I'll hand over to Mohamed and happy to tackle any further questions and details later on.

Mohamed Elsherief On the question regarding the local prices of the OCC, we do see stability in the market and we don't expect any fluctuations. Though we are expecting a bit of improvement due to the stability and the demand, as well as the slowdown on the export, due to the challenges of the Red Sea. We started to see some good signs from the relevant government authority, they started to reduce the issued permits. Based on the number we got from them, we are expecting to see 25% amount of permits compared to what we announced before. What we used to say, that almost average 100,000 a year of OCC export and we are saying this is slowing down. We had a couple of meetings, either with [inaudible 00:35:36] on Saudi export, where they start to show some understanding on this, where we start to see some good signs on availability of the OCC inside Saudi market.

Nour Eldin Sherif That's very clear. It should drop, actually, the exports by 25% or 75%, just to clarify?

Mohamed Elsherief 25% drop in the permits. This is what we got from them.

Nour Eldin Sherif Our next question comes from Shourouk. Please unmute yourself.

Shourouk Hi, thank you so much for your explanation, very detailed and helpful. I just have a few questions from my side. First I wanted to ask, I understand that the increase in the cost mainly coming from the tissue plant and the energy issues. But I want to understand in real terms, since the factory operated, how much losses was contributed especially from JUTHOR? That's my first question.

Sami Al Safran Just for clarification, the total cost which is represented increased, was driven by the sales volume and that's what we have impacted as a total cost. But the actual cost per unit for the containerboard side, [inaudible 00:37:12] for the tissue side, like what my colleague is mentioning, the main disturbing factor was actually the energy supply, the natural gas network was not available, and accordingly we have used alternative fuel, which is five times higher than the natural gas network and led to the contributed losses in the operation.

Regarding JUTHOR, [inaudible 00:37:40]. Don't quote me for that figure, but it constitutes almost 25% of our losses for last year. I need to verify the figure for further confirmation.

Shourouk Again, just to understand, is it that 20% of the losses is coming from JUTHOR?

Sami Al Safran Just give me some time and let me just confirm it. What's the other question, while we are checking?

Shourouk I want to understand if there is any update on Jeddah municipality agreement? How is it going there and how much is sourcing from that agreement your raw materials? I want to have that update and then I want to ask also about Mecca, if there is any update?

Sami Al Safran Regarding Jeddah, you are aware that we started almost end of 21, this is almost like the full second business year for it. That is moving in a healthy way. Definitely there are challenges, but now Estidama constitute of almost 22% of the volume supplied to MEPCO. We are aiming to increase this to 35 through the coming two years, so it becomes really a major pillar, that's from one side. From the other side, also we are focusing to expand the horizon of collaboration not to cover only the trading of recyclables, but rather to invest in the full value chain of waste management, i.e. the municipal waste, the waste to energy and all of those activities. We hope that in this year probably we might be able to share some news about it. That's regarding Jeddah.

Regarding Mecca, I will give you probably some feedback. You are aware that we did the MoU signature, now we are discussing the business opportunity with them. We hope that within two or three months we will be able to convert it to contracting facility.

My colleagues confirmed the figure for me, it's a 20% contribution of JUTHOR losses to the total losses that we have.

Shourouk Clear, thank you so much. If I may also ask a few questions about that you have a few reasons that is helping you to increase the prices, especially on the containerboard. You have the international prices going up and you have also the Red Sea crisis. On average, how much is the selling prices now comparing to Q4 for the containerboard, especially?

Sami Al Safran It's difficult, but probably my colleague, Ahmed, he mentioned that the PIX Index shows $45 increase, which probably this is a good sign to utilise it as a comparison. Probably going forward, you might see another 20 to 30. Of course you have seen that we have announced $70, but always we operate based on orders logbook because we are a 24/7 operating unit, so you will always see that the passing of increase takes time to ramp up from the increment side or from the decrease side. But I would suggest look into the $50 as an indication, the PIX is a good indicator to identify the business trend.

Amr Masry Just to add to Sami, we have seen a lot of price increase announcements internationally. Not all the price increases have been successful in full, some have not passed through the market. But as I mentioned earlier in my comments, that here the demand is quite solid, along with the Red Sea crisis, is enabling us to have an advantage over that. If you look at the official GCC PIX Index, it is showing the very specific window from Q4 to end of Q1, $35 to $40 increase in price.

Nour Eldin Sherif That's clear, thank you. We have a question from the Q&A box. Can you give us the volumes related to containerboard and tissues? And what's the update on the recyclable products?

Amr Masry For containerboard it's about 420,000 tonnes and for tissues it's about 20,000 tonnes in total. And what is the process of the production in regards to the recyclables and others, Mohamed?

Mohamed Elsherief Can you please elaborate more on that?

Nour Eldin Sherif We will wait for the question to be clarified. Just as a reminder, if you have a question please raise your hand or submit it to the Q&A box. Until we have the question, can you just give us an update regarding the M&A activity and if you have CAPEX guidance for 2024 and 2025?

Sami Al Safran Let me answer the part related to the M&A activities. Like what we mention in our prospectus, we are targeting an M&A plan, looking to complete the integration cycle of our business. Because currently MEPCO are investing from the backward integration into sourcing the fibre waste management into jumbo rolls production. And now we are taking a step downward, to move to corrugated boxes manufacturing. We are discussing with different entities, local and regional, and we are with some of them in advanced stages, some of them are in very early stages.

Definitely as a listed company we will keep posting about the progress or any milestone announcement that is coming. We are targeting within this year, at least we conduct one transaction and we share with the market going forward. I think this is really doable in our case. The benefit of course behind this M&A target it to reduce the cyclicality of financial performance of the business, as you can see. I think two critical things to highlight.

Number one, although the global performance is softening down due to economical stress, the case is a bit different in Saudi Arabia, as we are a growing economy. However, at the same time, it negatively impacted the raw material prices, but not the corrugated because the demand of corrugated remains the same. We believe that integration will help to mitigate the major cyclicality in financial performance and deliver value to the shareholders in a smooth way.

Nour Eldin Sherif That's really helpful, thank you. Shourouk, do you have a follow-up question or your hand is raised from the previous one?

Shourouk Just a follow-up question from my side regarding JUTHOR updates. As your presentation and what you mention is JUTHOR is on track to be profitable in the first quarter and to reach the gross margin target by 2024. My understanding is still that you need to rely on diesel and the utilisation rate reached 75% plus by the year end. How are you going to reach that profitability? Is it by massive increase in the selling prices or is it volume ramp-up? Or do you think the gas network by the year end will be fixed.

Sami Al Safran Shourouk, it's a good question, thank you very much. JUTHOR actually, if the gas availability are there last year, it would turn to profitability almost in Q4. Because the ramping, the cost of manufacturing, most of it are healthy. However, due to the reason that my colleague Amr mentioned, that alternative fuel of diesel is five times higher, that's what really creates the losses in JUTHOR. The good news is that we have been communicated by [Inaudible 00:46:53] that the natural gas network is ready for connection. Now we are working with the ramp-up. We believe in April, early May we will be completing most of the connection activities and that positively will impact the financial result to the targeting EBITDA. But probably I would give my colleague, Amr, to elaborate more, if there is any additions.

Amr Masry Shourouk, December would have been positive for JUTHOR, given that we were running on natural gas and not on the current situation, on diesel. The factory is supposed to break even at around 60%. We have achieved 65% already in December, but given the fact that we are running on diesel, definitely that did not happen. We expect this to rectify by early Q2. If it did not rectify by Q2, we still do expect the factory to be profitable in Q2, even if we continue on diesel, but definitely with lower margins.

Shourouk Clear, thank you so much.

Nour Eldin Sherif Just as a final reminder, if you have a question please raise your hand or submit the question in the Q&A box.

Amr Masry The attendee with the question about recycling did not come back with a clarification on the answer. Can we please have a clarification?

Nour Eldin Sherif I think Amr, if there's further clarification required, they would contact directly to management, if not through us, as well. I'll turn over the call back to you for conclusion remarks from management. We have just one final question from Fouaz Khalid [unclear 00:49:42] here. Please unmute yourself.

Fouaz Khalid Thank you. Mr Amr, I just have a question regarding the sourcing of the raw material. I know that was previously mentioned, but I just want to know if you can please quantify the amount of pulp that is sourced, not internally, within the company's resources. Because some of it is resourced through the recycling, but another part is not, so can you just please quantify that? I'm still trying to understand that, it's a bit of a grey area.

Amr Masry Hi, Fouaz. Mainly for the Mainly for the pulp for the containerboard, 80% of the pulp is sourced internally. If you go back to my numbers, we said around 420,000 tonnes, we've sold from this 420,000 tonnes 80% of it is locally sourced, recycled paper. For JUTHOR we sold 20,000 tonnes. All of this, 100% is sourced from virgin pulp.

Fouaz Khalid And the 20% pulp that you mentioned, this is externally resourced, just to clarify?

Amr Masry Because we have a variety of products, so this is due to a mix of a little bit of virgin pulp and the recycled pulp.

Sami Al Safran Fouaz, we're actually focusing on two business units. When we speak about JUTHOR for the tissue, the majority of the raw material are imported pulp from abroad, like what my colleague is mentioning, and subject for the increase and decrease. Regarding MEPCO, which is the containerboard and paper board, this is usually sourced, the majority of it, more than 80% from Saudi Arabia, from what's called ex-waste paper or old corrugated paper or old cartons. Those represent the majority suppliers of our pulp and we source it from our own source companies, WASCO or Estidama, which is the new company formed with the Jeddah Municipality. However, certain grades, like for example white top, craft top, for example water boxes and others, we need to import some virgin material from abroad and add it to the top layer.

Fouaz Khalid Mr Sami, just the clarification, what was basically resourced in terms of from the company resources, even if it's from subsidiaries. And that answered my question clearly, thank you.

Sami Al Safran My pleasure.

Nour Eldin Sherif I that concludes our call for today. I will turn over the call to management for final remarks. Thank you.

Amr Masry We'd like to thank you all for attending this call, it's great to see you every quarter. We hope that we'd see you in the next quarter, in Q1. We should anticipate results to be much better in the first quarter or significantly enhancing in Q1 2024. Thank you all for your attendance. Please feel free to reach out, either on the IR or directly to us, as management, any time you have a question or a clarification. Thank you, Nour and Arqaam Capital for organising this.

Nour Eldin Sherif That's our pleasure. This concludes our call for today. You may now disconnect, thank you.