Middle East Paper Company

CONFERENCE CALL DEDICATED TO MEPCO FINANCIAL RESULTS Q1 2023

Date: 21.11.2023

Participants:

- Sami Al Safran, Group President
- Ahmed Fazary, Group Chief Commercial Officer
- Amr Masry, Group Chief Financial Officer
- Sarah Moussa, Investor Relations Manager

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 Third Quarter Results Conference Call.
I have with me here today Mr Sami Al Safran, Group President, Mr Amr Masry, Group CFO, Mr Ahmed Fazary, Group CCO, and Ms. Sarah Moussa, IR Manager. With no further delay, I will turn over the call to Ms. Sarah.

Sarah Moussa Thank you, Nour. Good day and good afternoon, ladies, and gentlemen. It's our pleasure today to come and talk to you about the financial results of Q3 fiscal year 2023, but first allow me to start the presentation with a disclaimer.
This presentation is prepared by MEPCO and contains basic information about the company activity as of 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 a basis for investment recommendation, solicitation, or 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 know that 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 in financial modelling or investment decision-making, and thus takes no liability to explain differences between future actual results and what was stated in the course of this presentation.
Now, like Nour has presented, we are here accompanied with the Group President Engineer, Sami Al Safran, Amr Masry, Group Chief Financial Officer, Ahmed Fazary, the Group Chief Commercial Officer.
In the nine months of the fiscal 2023, and specifically in Q3 of 2023, we managed to increase the sales revenue Q-to-Q. We increased the sales volume. JUTHOR started to ramp up, reaching to a sales revenue of SAR38 million. We generated healthy cash flow from operation, and we maintained healthy liquidity ratios.
But despite that, given that currently we are still witnessing a decline in the demand of the containerboard, which consequently has affected negatively the international selling prices, we incurred a net loss of SAR45 million, totaling in the nine months of 2023.

But even though globally there is a decline in the container global demand, we are witnessing a very healthy Saudi Arabia demand for the containerboard as well as for the tissues, and we are seeing still a growth in the non-oil activities in the GDP contribution. Even though in this quarter the GDP in Saudi Arabia has declined by 4.5%, mainly backed up by a decrease in the oil activities by 17.3%, I would say that still the non-oil activities are contributing to Saudi economy by 3.6%.

We will see that still in the containerboard demand, the growth is still as previously communicated. We are not seeing that much of a growth this year in 2023. But for the international prices, we previously, in the previous, last call of Q2, we said that we are seeing much decline in the international prices, but this is not seen right now in that quarter.

As you can see, Q-to-Q, prices have generally decreased by 2.8%, while the OCC decreased by 14.6%, so this gives a hint that the prices right now are taking a stabilized movement, and that we are not going to be seeing much steeper decline going further on.

Now, in the last call, we said that the management has communicated that there will be a GCC Price Index specifically for the containerboard, which is a very important index that we will be communicating with you going forward, each quarter. And this actually portrays on the ground the real benchmark for containerboard selling prices, for the whole Gulf countries area.

We will also see that the index has started launching since 6th June 2023, and we are portraying it to you on a monthly basis. And here if you will notice, you will notice that it is almost close to the benchmark that we used to communicate with you, which is Test liner Two of Italy, and you will find that the decline is also not so much. It's not that much compared from Q-to-Q.

This quarter and this time in the GCC Index, we are choosing to also disclose to you not only the test liner for the GCC prices, but also the fluting, which both they fall under the containerboard category, and they contribute around 60% of the total sales volume of MEPCO as a group. Q-to-Q, the GCC prices pertaining test liner and fluting have decreased around 7%, but as the global prices are witnessing a stability, the Gulf Country Index as well is witnessing stability in the prices, which of course will be reflecting on the OCC prices.

Now, coming to the tissue market, the tissue market is witnessing a better demand than the containerboard. We previously communicated with you, that we are anticipating net income in the third quarter of fiscal year 2023, but due to some increase in the direct cost of manufacturing by 40%, we did not realize this quarter net income, which we are not anticipating that the same conditions will be happening for the fourth quarter or going forward for 2024.

So, the prices of the tissue we are benchmarking against the international prices of the pulp, and we have seen a relative increase in the selling prices of the pulp, which is the raw material for the tissues. And consequently, we are expecting that our selling prices will relatively increase as well.

Going through, of course as I communicated with you in the beginning of the presentation, we had an increase in sales revenue and an increase in the sales volume. And despite the challenging global containerboard demand, MEPCO still continues to prove its market leadership, its resiliency, and its ability to, despite these challenging conditions, to actually increase the sales volume Q-to-Q by 11%, and even by 1% year-on-year, keeping in mind that last year we were witnessing healthy containerboard at that time.

And of course, utilization rate of JUTHOR has in Q3 reached to above 50%, and this has generated SAR38 million for the top line, and tissue local sales have contributed around 6% of the total sales revenue. Of course, for this quarter, it was all contributing to the local sales.

For our financial review, we witnessed an increase Q-to-Q in the sales revenue by 21%, despite having our sales prices decrease by 8% and our average cost of sales per ton increasing by 11%. And we also witnessed an increase in the gross profit and the gross profit margin, from 12% to… Sorry. From SAR23 million to SAR24 million in the gross profit. And the gross profit margin has decreased

from 12% to 10%. This is given the fact that there has been some increase in the cost of sales, which is only pertaining to one-time-off of the maintenance cost increasing by SAR9.7 million, which we will communicate with you in the next slides.
But looking at the breakdown of the cost of sales, we will find that we still managed to decrease the OCC prices Q-to-Q by 7%, and even though we have an increase in the sales volume by 11%, which, as we have communicated with you previously, that we are working on managing the cost of the OCC and increasing it, we delivered what we promised. And year-on-year, the decrease on the fiber cost has decreased, due to a decrease in the OCC by around 33%, while there has been an increase in sales volume by 1%.
Of course, this has reflected on the EBITDA, increasing from SAR11 million to SAR16 million, by 45%, due to the lower OCC prices and as well as some decline in the costing, precisely in the G&A expenses. And of course, we cannot hide the fact that all the margins are declining on year-on-year, given to the fact that there is a decline in the international prices.
Now, what has impacted on favorable terms and unfavorable terms our bottom line, we will find on this quarter, there has been an increase in the sales revenue by 21% for the increase of containerboard and tissues. The selling prices, that include both containerboard and tissues, have increased by 11%. The cost of sales has increased by 23%, due to the increase in maintenance cost by SAR9.7 million.
The G&A expense has decreased by 23%, and even though selling and distribution increased by 14%. That's given to the fact that the export sales volume has also increased, but there is also a non-cash expense increase equal to SAR1.6 million, and this is because of JUTHOR launching.
And when we come to… Sorry. And for the financial challenges, of course it's no hidden fact that there is an increase in the interest rate, and it has increased Q-to-Q by 72%, equal to SAR3.8 million. On a year-on-year basis, our favorable contributors to the bottom line, the selling and distribution, decreased by 29% due to the reduction in transportation and shipping. Our… Due to increase of customer collection, which has affected the impairment gain of financial assets.
There has been other income increase, backed up by an increase in the foreign exchange again, Saudi Riyal versus Euro, equal to 125% and equal to SAR3.2 million, increase in other income, pertaining insurance claim recovery and other sales.

The unfavorable conditions, of course the sales price and the increase of the cost of sales. Some one-time of non-recurring expenses has been incurred, such as the WASCO penalty, amounting to 22% of the net income, and we do not foresee something like this to happen in the coming quarter or in the coming year. Bonus and incentive around 16% of the net income, just non-recurring expenses, not happening again with that amount. And of course, the last item, the equity shares of employees, around 3% of the net income. And definitely, the financial charges increased for this year by 59% , year-on-year basis.
Now, we, MEPCO, is really leveraging and it's really good in managing its working capital, and even though we are going through some challenging conditions, MEPCO's still maintaining very high liquidity ratios, and that's basically we are maintaining better inventory management, high customer collection, and well-placed credit insurance policy. So, you'll find that the working capital ratio last year, it was 2.47, and this year it is still high and it is now reaching to 1.66.
For the cash flow from operation, we are still also pioneering in producing a high level of cash flow. It has increased year-on-year by 19%, and this proves our resiliency and our pioneering in our management in terms of liquidity. Our net debt to equity, it is still remaining into the normal levels that we always see each quarter. It has only slightly decreased year-on-year, from 0.46 to 0.43.
The short-term debt decreased actually by 9%, from SAR102 million to SAR93 million, while the mid-term only increased 7%, from an average of SAR460 million to SAR491.

Our net debt to EBITDA decreased by 0.57 due to the increase, of course, of the EBITDA comparing to previous year, as this is a temporary situation due to the current incurred losses, which is of course expected to be recovered once the international prices markets picks up and we go into the upward cycle of the industry.
Now, the management outlook. We are still abiding with the implementation of MEPCO's growth strategy, despite the current challenges. We are still working on market involvement, market penetration for the GCC, in order to increase our market share, and we are still into pioneering in cost management in an inflationary economy. Thank you so much for listening to me, and now I will leave the mic to Nour to have the questions received from you.

Nour Eldin Sherif Thank you very much, Sarah, for the presentation. So, now if you have a question, please raise your hand or submit your question in the Q&A box. Okay, so until we get our first question, let me start with a question on the expansion of JUTHOR. If you can give us an update regarding the current utilization rate and the expected margins for JUTHOR in 2024, please?

Amr Masry Yes, hi. Good evening, everyone. In terms of JUTHOR, we have exceeded the 50% utilization margin in our productions, and as we penetrate the market, we hope to continue further to reach above 65% or 70% by the end of this year. In terms of the margins, we are working hard on enhancing the market. As you know, this is our first year, so market penetration is our key focus until we achieve a significant market share.

Nour Eldin Sherif That's clear. A question from Abdurrahman. Can you disclose your average selling price for the tissue jumbo rolls? And are prices currently high or low, or within the average range?

Ahmed Fazary Okay, again, I confirm that we cannot disclose prices, but let me shed some light on the tissue pricing, opposed to containerboard and paperboard. Definitely, the tissue is less volatile in terms of prices, but of course it also follows the economy, it follows the dynamics of demand and supply, which have also witnessed a sequence of price drops in the past months.
Again, we confirm that this, we've reached the bottom. Fiber costs are on the rise, and it's squeezing everyone in the industry to announce price increases. I'm happy to share that we are the first to announce a price increase, last month. We announced it for this month, for the tissue. So, this is what I can share at the moment, but prices per se, it's not something that we can disclose.

Nour Eldin Sherif Yes, clear. Another follow-up from Ahmed. Where is the decline in OCCs coming from, despite high volumes? Is the new Waste Management Law behind this?

Sarah Moussa Can you repeat the question, Nour, please?

Nour Eldin Sherif Yes. So, where is the decline in OCCs coming from? This is the first part. And the second part, is the new Waste Management Law behind this?

Sami Al Safran Yes, it's a good question. Answering the question regarding the OCC, actually it did not decline in terms of price. OCC actually went higher. But the reason why it has shown in MEPCO books that it's at lower cost, is due to the fact that we are backward integration, and since our WASCO and Estidama are controlling the majority of the market, we are able to control the raw material prices, not to run out from our end.

However, internationally, anyone who is monitoring the index, he will see that quarter-on-quarter there was increase by almost 15%, around 15% to 20% in the raw material prices.
And speaking about the volume, yes, we have noticed actually in 23 a great volume evolution for the fiber collection, so between 23 and in 22, we have noticed an increase into the volume generation in Saudi Arabia by almost at 20%. I.e., what proves that one, in addition to the local consumption of the existing operating plant, we have noticed that the export went aggressively high during this year.
But answering the second part, the National Waste Centre launched the restrictions on export of waste in mid of 21, and accordingly at that time, the export of waste went as low as 85,000 T. Whereas this year, for some reason we cannot explain it, the National Waste Centre went aggressive and they provided license of export for many traders, which we have noticed that this year will be ending up by an average of 400,000 T of export.

Now, from one side, this is good news. That means the available resources of our Expansion Project are there. The fibers are available in Saudi Arabia. But from the negative side, definitely it puts the pressure in the local OCC prices, that makes it coming back again double than the European prices.
And this is one of the reasons actually contributing into the aggressive losses for this year, is that the raw material prices ran out of control and went back to be double than our peers in European market.
And now we are working aggressively with MAWAN to reactivate the process and regulate it, to avoid any damages happening to the local mills.

Nour Eldin Sherif Very insightful. And a follow-up. What's the reason behind WASCO's penalty?

Sami Al Safran I think the case was addressed. It was actually, as usual, a claim into anti-competition, claiming that WASCO is monopolizing the market with the other parties, and the penalty resolution came to apply fines in WASCO. Now, we have filed an appeal case, but as a conservative approach, we already registered the fine amount, which is SAR10 million, SAR5 million for last year and SAR5 million for this year. If things go into the favor of our appealing, then hopefully we will reverse back that amount. Otherwise, if the final resolution came, then it will be continued without further impact on our financials.

Nour Eldin Sherif Yes, clear. So, there are no further questions on the chat box, or no one is raising his hand. So, as a reminder, if you have a question, please send it to the Q&A box or raise your hand.
Another follow-up from Ahmed. What's the current utilization rate? I think that's related to JUTHOR, I assume.

Sami Al Safran Yes, I can answer actually both of them, but probably let me speak about the… If I can broaden my answer beyond this one. It's a very critical question that, what has happened this year? I.e., the major consideration in the profitability. Actually, this has been impacted by the global situation of the containerboard market. After the peak crisis of selling prices in 22, and overstocking, then the market went into a dramatic correction.
We have noticed this correction started in Q3 22 and continues all the way to this quarter. It is a very normal correction after the major escalation. However, from the other side, we have noticed that the operating rate of the international papermill went as low as 80%, whereas MEPCO, we kept our operating rate into the normal level, which is above 90s%.
Now, this is one of the main advantages of MEPCO, that we are geographically distributed in a favorable geographic location, so although the demand globally was soft, but that was not a reason for us to slow down our operation. Rather, we kept our operation as high as it should be, to reduce

the fixed expenses, and we maintained our distribution of sales between the local and the international.
And that's probably one of the resilience capabilities of MEPCO that shows how we try to mitigate the fluctuations happening in the business, and to position ourselves into a different favorable situation.
But from the other side, that also paved the road, that the strategy that we are following in MEPCO and the logistic advantage we have, gives us a comfort step to move into our expansion growth, without really a concern risk that we are carrying with us.
You might notice that the same applies with the case of JUTHOR. Our plant in Ju JUTHOR , as a new operating plant, we will operate at 65%. Thankfully, our team have brought the operating efficiency up to 80%. We have exceeded our budget. Like what my colleague mentioned here, probably that contributed to the top line, but probably it didn't contribute to the bottom line, due to the start-up of the machine.
We had some issues regarding the fuel supplies, which increased the cost of operation, and it was the balance for our pulp supply and demand, which is a major contributor of the tissue. However, probably to throw more positive signals, before the commercial operation of JUTHOR, we managed to execute our sales based on MEPCO reputation.
After the start-up, we have covered our demand in the market. We successfully launched a quality and beautiful product, that it was not a problem for us to sell to almost more than 95% of independent players. The only one who's not buying from us now are the integrated players.
More and above, for this month, we started our export. Thanks to our Commercial Team, we have started to deliver our goods to the nearby countries. And again, MEPCO has leveraged strength in terms of an export arm, which is something we are intending to do with the tissue, and that will give us really the capability to smoothly grow in our tissue capacities and create a champion in the local market.
More and above, I would like to speak also about probably the announced transactions of the PIF subscriptions. We have almost come into the final stage. We believe with the progress we are doing, potentially the transaction will be completed before the end of this year.
Very soon, you might see our announcement regarding the approval, the EGM and the execution of the plan. That built the confidence of the long-term strategy we are applying in MEPCO here. And definitely, I think most important is that your presence in this conference call shows your confidence and your interest about the business, which we are committed to deliver the result to you guys. Thank you very much.

Nour Eldin Sherif That's very clear. We have a final question here from Ahmed. Any color on how the finance of PM5 will be? And if you decided on where the land for the project will be located?

Amr Masry In terms of financing, guys, if you might allow us until we have information that we can disclose about the deal with PIF. We are about to finalize. We have to say that SDIF remains our main partner. Like our previous projects, including our expansion in PM3 and JUTHOR, we will detail all the financing of the project once the project is fully announced. And in terms of the lands, we are currently in the process of choosing one of two locations that we're trying to finalize. How long, Sami? Is it two, three weeks?
Sami Al Safran Yes.
Amr Masry In two, three weeks, we will have an announcement regarding the PM5 update.

Nour Eldin Sherif Amazing. Thank you very much. It seems like there are no further questions. I'll turn over back to you, if you have any final remarks before we conclude the call?

Sami Al Safran Nothing. Thank you very much, gentlemen, for your patience. No doubt, this year was a very difficult year, but at the same time it's an interesting year for us, that we are really shaping up our strategy, putting our strategy on an execution.
We are very excited to be recognized by the anchor investor, and we are trying to create a value for our shareholders towards the long-term investment and execution. And one of the key pillars we are taking as a measure, also, is to mitigate the cyclicality and performance based on the market situation. And probably if you read our strategy, you will find those are one of the key elements we are focusing in, which hopefully with the very nearby future announcements, you will see the measures we are taking to mitigate the cyclicality of performance.
Until then, we will keep ourselves on a shape-up, we'll mitigate our costs of operation, and we'll enhance our performance to capture the global opportunity coming to us.

Nour Eldin Sherif Thank you very much, Engineer Sami. And thank you, everyone, for joining. This concludes our call for today. Thank you.

Sarah Moussa Okay, thank you, Nour.