

## MEPCO 1H 2019 Results Call – Transcript | 8 August 2019

- Tim: Ladies and gentlemen, thank you for standing by. I would just like to welcome you to the MEPCO first-half results call. At this time, all participant lines are in a listen only mode. The format of the call will be a presentation by the MEPCO management and investor relations team, followed by a question and answer session. After the call, if you would like to ask a question, please press five followed by star button on your telephone keypad and wait for your name to be called. So without further ado, I'd like to pass the line to MEPCO. Bassem, the floor is yours.
- Bassem: Thank you everyone for joining us today. I'll start today's presentation by citing forward-looking disclaimer. This presentation may contain forward looking statements. While management has made every effort to present a fair view of MEPCO's operational and financial performance, it is important to acknowledge that expectations about future results would come in life of prevailing operational, financial and market conditions may change in the future. Management does not give forward-looking statements for financial or investment decision making purposes. It does not take responsibility to explain differences between future and actual results taken in the course of this presentation. I would now hand the call over to the CEO for an overview about the first-half of this year.
- Eng. Sami: Good afternoon gentlemen. I'd like to thank you both for joining us in this meeting. We would like to present the financial results performance of MEPCO for Q2 2019. Which is the results that being shown as expected earlier for the indications that were mentioned. We know this is not the best conditions we are talking about. However, we are here to answer your questions and concerns that you have.
- Eng. Sami: I would like to start to speak about the international market performance. We have seen by the close to the year end of 2018 an indication of a global downward, the trend of the container board the prices driven by a high inventory level. And due to some economic slowdown that shown and indications of a drop in the demand. Accordingly, we have seen that the finished product prices have responded and start to move and the download of the trends, which we have mentioned earlier, continued until our discussions. However, the main differences we have noticed that the, the deterioration of prices is almost coming to the bottom. We don't see indications of further a drop in the prices.
- Eng. Sami: While this process is going on, a couple of international advisors tried to boost it up through an artificial announcements of price increase which has not been actually translated in the market nor have the market has responded for it. From the other side, since this is not the first time that MEPCO follows cycle, we have taken the required measures in term of what MEMCO is responsible to do. And mainly we have focused into improving our efficiency, reducing our costs from different angles, and trying to materialize such situations for the benefit of the company. For example, we have managed to that time to increased our sales volume, whether local or internationally, which you might see that we

have I think reported area that we have recorded the highest sales volume and each one comparing with the previous half of the previous year.

Eng. Sami: At the same time, while everybody knows what is happening in Saudi Arabia market, our receivable collection performance was doing great. We had actually one of the successful sellers of that one. And from the other side, we continued actually our strategic plan and review of our global strategy because we typically, from our previous knowledge, we know usually paper industry is a cyclical process where the prices goes up and down. However, we have always to maintain and grow our strategies.

Eng. Sami: We are very actively from both sides, whether from MEPCO side as the thing is organic growth or assessing the vertical or the integration. Or from the other side also, you might see earlier that we have silent agreements with Roland Berger to revisit the whole structure of WASCO and to put it inline with the 2030 visios because distinguishing WASCO as one of the few companies in Saudi Arabia who is having the capability for the waste management with the volume that is mentioned. I will hand over the discussion now and the briefing to Mr. Darwesh for some elaboration of the financial results. Then it would be able to pick up and answer questions from your side. Please.

Dr. Darweesh: Thank you everyone for joining the call. The results factor the sharp price decline for international paper prices. This affected our income statements from the sales revenue and levels to net income, and earning per share. We achieved a significant savings of cost of goods sold by around 11% in terms of fiber, chemicals as compared to the same period of last year. For example, raw material cost per tonne decreased by 13% a year over year. Energy cost reduced by about 20% year over year. Our total debt increased to 678 million Saudi Riyal, slightly by about 1.3%. The cost of debt reached to 20.9 million, slightly increased by 1.4%. Our overall debt to equity remains almost same at .90 which is very healthy. We are generating enough cash to go to manage our daily operations. We have around total 1.4 billion banking facilities, of which only 678 million utilize it. And hence, more than 60% of facilities are available, aren't utilized. We are now dealing with a bank to reduce pricing on existing loan facilities and shifting from SIBOR to LIBOR . Now I will hand over the operator questions and answers session.

Tim: Thank you very much. I would now like to turn to Q and A session. If you have any questions, please press five star on your telephone keypad and listen carefully to hear the line un-muted command. Just a reminder, that's five star and we'll give it a second or two.

Abdullah Zaid: Hi, good morning. Good morning. Good afternoon everyone. This is Abdul Azaid speaking from Fastmarkets RISI. My question is about the possible expansion in capacity. What is the plan for that? Especially in this market conditions? Thank you.

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- Eng. Sami: Good evening. It is like what I mentioned in my, in my short sentence there. Paper industry money is usually that long life industries. You don't respond to really that incentive movements because globally, the industry are growing in a healthy demand. Even with the financial That we are in right now. The demand is there and that's what we mentioned earlier that MEPCO have recorded their sales volume and each one.
- Eng. Sami: Now I think you're interesting questions is there. This is the reason that we do an extensive assessments for that project. Not only for the import but actually for multiple activities that we are doing. And we will come up really with the right decision at the right time. Answering your question, is it something that's been deactivated? No, it's not been deactivated. Yes, it's still on the team there doing the work for us. One thing, just to highlight that you might notice that the major changes in the import material prices and the finished good prices. And that creates some challenges when you build your financial model to try to come up with this table, figures that to be a presentable for discussion. That's probably what really stick in our time for sometimes to come up with the final conclusions for the recommendation.
- Abdullah Zaid: Okay. Thank you.
- Tim: Any more questions press five star please. Thank you.
- Speaker 1: Okay we have a question from Anoop Hernandez from SICO. Thank you.
- Anoop Hernandez: Yeah. Hi. Good afternoon. Thanks for hosting the call. Could you please give us a sense of what the volumes were during the quarter and what was the price average realization and how do prices stand currently compared to the previous quarter?
- Eng. Sami: Usually we avoid declaring the actual figure for the reason that is market compulsions and everything you know, to make ourselves distinguished with. However, in the previous discussion we mentioned earlier that MEPCO usually operates in the range of 400,000 annually and usually we increase in a plus and minus 5% to 10% based on the demand of the market and the performance of our production. Regarding the price dynamics, I think if you can access the global indices and check that differences between 2018 and currently 19, we are almost aligned with that one because keeping in mind that our region and Middle East represents 4% of the global demand of 171 million. So typically you will find that we are price taker and that's the price maker. Especially that we are competing globally and more, more than 40% of their company production is being exported to different region in the world. And that's why we have to be in line with the international indices.
- Anoop Hernandez: Just to follow up, there was some news recently that OCC prices have collapsed in the US, 30 odd dollars. Is there any benefit that the company can gain by maybe importing from the US market or somewhere? Would it give you some

sort of a cost advantage after all the transportation, all that or is that not feasible?

Eng. Sami: It's true. Let me just elaborate. I think your question is important. Let me share with you the background behind it. Now, organically in Saudi Arabia you would find the cost of the raw materials, which is OTC are on an average of 50 to 60% higher than the global prices. And this continuous due to that, the lack of regulations in Saudi Arabia, the lack of waste recycling which really exert companies like WASCO to collect which has an inherent inner cost.

Eng. Sami: Now there's I think to for us two important measures that happened. Number one is the Chinese green principle which drove the demand of the OCC globally and accordingly drove across the whole region, raw material prices. And yes, if you check a lot of our cost of manufacturing you will find that we didn't have an advantage of that one by the topic you mentioned that we did import some of our quantities from outside.

Eng. Sami: I'm not going to have the actual figures, but I believe almost like this year we imported 40,000 ton from US enjoying the benefit of the top in the prices. Now coming to the second point, which is going forward, it is known that Saudi Arabia, two years ago and last year we have announced about national a strategy of waste management. And I think a company created by the name of Saudi Recycling Company, which the main objective behind it is to improve the waste recycling in Saudi Arabia and to be in the level of the modern countries like Europe. Which was actually focused in recycling 80% of that generated waste in Saudi Arabia back in the system.

Eng. Sami: Now how does that will help us? Currently the available waste collected the Saudi Arabia is almost 1 million ton against the available consumed paper in Saudi Arabia, which is more than 3 million tons. So there is almost another 2 million is going to the waste. We believe by launching those regulations, there will be a major improvement in recycling the process which will positively impact that costs of the collected materials, which is the OCC. So in the long road we believe the raw material prices in Saudi Arabia should respond positively to it. And this is what we mentioned earlier is when you engage Roland Berger with WASCO because we believe that a great opportunity in the waste management industry and as a direct material converter site.

Anoop Hernandez: Is there any estimate of how much would be the benefit if these recycling plants kickoff as expected and the 3 million ton of waste paper becomes available. Could you quantify what would be the benefit you would get in terms of the cost of raw material?

Eng. Sami: In a simple thought, like what they mentioned to you, today the average costs of a, I mean let me give you an average of let's say 2016 or 17, you will find while the OTC prices abroad is at \$120 you would find in Saudi Arabia reaching up to like one 180 or 190. So there's almost a 50% higher cost in the local

market than international. I believe when those regulations launch properly we should really come in aligned with the international prices.

Anoop Hernandez: Okay. So thank you very much.

Tim: Okay, so we have a question from Mohammad Jindi. Please go ahead. Thank you.

Mohamed Jindi: Yes. I went to ask about a gross profit margin. It declined from around 28 to 18. What's the major component and the reason of that?

Dr. Darweesh: The main reason is we have two factors impacting our gross profit, to which is multiple fold, and [inaudible 00:16:28] as well as sales volume. The volume improved by about 2%. Cost of good sold dropped by about 11% apart another another factor regarding <inaudible> dropped by about 22% This impacted negatively our gross profit to drop from 28% to about 20%.

Mohamed Jindi: How do you likely expect a recovery and in the margin?

Bassam: Could you repeat that please?

Speaker 1: How do you anticipate the margin to improve back to normal levels?

Dr. Darweesh: As mentioned by Mr Sami now first of all , (inaduble). Sales prices have reached to bottom. We are looking from other angle to increase our sales volume and also more cost savings. I think this will improve the gross profit until we have a recovery of the sales price.

Mohamed Jindi: Okay. Thank you.

Tim: Okay, so any more questions it's five star. We'll give it another two seconds. Thank you. Okay, so we have another question from Abdul Azhed. Please go ahead.

Abdullah Zaid: Hi guys. Again, I'm trying to understand the local versus exports sales in 2019 versus 2018 I see the exports were lowered slightly in 2019 first-half in terms of percentage wise. Does that express some sort of further weakening in the region compared to Saudi Arabia or how can you explain that?

Eng. Sami: No, actually like what I mentioned before gentleman, through the investments that we made in MEPCO, we were one of the few companies in the region that pioneering in the export that we are maintaining an average of 40%. At the same time also, three years ago we invested in diversifying our grade from 2 to 9. Now the way how we operate it in our sales is that when the prices goes down, we try to select the market and the product that has a better return and focus on it.

- Eng. Sami: So usually when the drop in the prices, we try to avoid the remote market that has a higher logistic cost for the favor of the local market, which has the lower logistic cost. And that is the main reason. It doesn't mean that we are losing markets, we can be there at anytime because like what they mentioned, ultimately you are talking about 171 million ton markets all on sort of the world. And it's accessible to us. So we selectively choose those which have the better return. Meanwhile, due to the conditions we try to focus more in the local market, which has a lower logistical.
- Abdullah Zaid: Okay. And that also applies to the conventional versus non-conventional grade. Right? So same kind of logic?
- Eng. Sami: True. However some minor change has happened. I think the people who specialize in the field, when you seen the OTC prices, which they recycled grid, prices dropped down. The virgin prices of the bulk materials took slightly longer time before it respond. And that's why maybe if check our first half of the year we focus more in the conventional versus the non-conventional due to the cost of manufacturing or that that the margin is better. However, what we have seen now that the raw material of the virgin bulk drop down, which really gives us now the appetite to go back again and increase our volume from the net conventional grade.
- Abdullah Zaid: Okay. Thank you Eng. Sami.
- Tim: Okay. Thanks everyone. If there's no more questions then I'll hand it back to Bassem for closing remarks. Bassem?
- Bassem: Okay. I think we don't have further questions and we hope that we answered your questions thoroughly. If you have any further questions, please contact us. You have our contacts and this is my personal contact with all available to attend to any of your concerns. And hopefully we'll see you withs EFG in London or afterwards in Dubai, we're dedicating the 26th of September, we're flagging it for a meetings with investors. I'll hand over to the CEO for final closing remarks.
- Eng. Sami: Thank you very much gentlemen for attending the conference. I would like to highlight that we at MEPCO yesterday we have actually celebrated our 19th anniversary. And individually we have almost an experience of 25 years. For those number of years, we have notice the cyclicity of the market and usually when it's funded, and this is the main reason why we at MEMCO try to build a sustainable model by focusing in different things between geographic distribution of our business between improving the efficiencies, localizing it and increasing local content and also elevating the qualifications of the local citizen to jump in their industry.
- Eng. Sami: I believe this is our responsibility through the business, through the investors, as to maximize the benefits for us and reduce the cyclicity and reduce the risk.

And this is why maybe you will find us where others are concerning from market situations in the region here. You don't find really, we haven't that concern for the reason that we established the company to be a global player. We wish you the best luck and Inshallah for a brighter future for the company. Thank you very much.