

MIDDLE EAST PAPER COMPANY

CONFERENCE CALL DEDICATED TO MEPCO FINANCIAL RESULTS FY 2021

Company: MEPCO

Date: 21.03.2022

Participants:

- Eng Sami Safran, Chief Executive Officer
 - Mr Jhan van Vuuren, Chief Financial Officer
 - Mr Bassem ElShawy, Head of Strategy and Business Development
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Operator:

Good afternoon. Ladies and gentlemen, thank you for standing by. I would like to welcome you to MEPCO Full Year 2021 results call, on 21 March 2022. At this time, the participant lines are on listen-only mode. The format of the presentation will be a management team presentation, followed by a question and answer session. Without further ado, I would now like to pass the line to Bassem, Head of Investor Relations for MEPCO. Please go ahead, sir, the line is yours.

Bassem Elshawy:

Okay. Thank you very much. Welcome everyone. Thank you for joining us again today for the results call for the financial year, 2021. This year has been, by all measures, an outstanding year, in terms of financial and operational performance. We have shown that this market is holding and we are very well positioned to give our shareholders the highest returns possible.

Bassem Elshawy:

We have seen what we call, a very surprising year, and this was not surprising to us, on our end, as we have fore-saw this kind of trend coming. Months before, we have given the market a heads-up that prices are increasing since the last quarter of 2020.

Bassem Elshawy:

The thing that we would like to highlight at the beginning of this call, is the management readiness for capturing this opportunity in full spectrum. The amount of infrastructure, investment, human capital investment, and the strategic deployment of our initiatives, came perfectly in time.

Bassem Elshawy:

What we see in this result that we have posted a couple of days ago, is the translation of all these efforts as they come in this year. The superior performance that we've all seen, especially in Q4 of 2021, comes as a result of consecutive, well-timed price increases that have been brought to the market. And they come in alignment with the international price trend. As MEPCO is the largest producer of container bought and people bought products in the Middle East, this position gives us leverage to be able to extract value, and to give value back to shareholders, who are supplying our customers.

Bassem Elshawy:

The other thing we want to shed light on today, is the growth initiatives. As you are all aware, paper prices are technical in nature, and this is something we have taken into consideration when we were formulating our strategy back in 2020. It is one of the pillars, why we pushed forward with starting investment in tissue [inaudible 00:02:52] manufacturing, to reduce the volatility of revenues, and accordingly, in a net profit, and also to enhance the profitability of the group. The tissue project has been going very well according to schedule. We are still committed to starting commercial operation in the first quarter of 2023, as promised. This is going to be the first significant impact in changing MEPCO into a full fledged champion of data manufacturing in the Middle East.

Bassem Elshawy:

The second initiative of course, is the [foreign language 00:03:25], which is the one venture that happened between WASCO MEPCO's old subsidiary and the Jeddah [foreign language 00:03:34], to give WASCO the exclusive right of collecting recyclable material in the City of Jeddah. This project has kick started a few months back and since then, we've seen exponential growth in the amount of recyclable materials that arrive to the collection centers, and we have reached significant milestones in collection so far. We are very much looking forward to completing one year of operation in [foreign language 00:04:01], and to rolling out this model into other regions of Saudi Arabia.

Bassem Elshawy:

These are the main highlights we wanted to talk about in the introduction today. I will pass the floor to you for question and answers. I'm joined here by Eng Sami Safran, the group President, and Mr. Johan van Vuuren, the group CFO. Please go ahead.

Operator:

Thank you very much. We will now be moving to the Q&A part of the call. If you have any questions, please press star, two, on your keypad, if you are dialed in by the telephone. That's star, two on the keypad. If you're dialed via the web, you may also ask a voice or a text question. We will now give a minute or so for the questions to come in. (Silence).

Operator:

Once again, for any questions, star, two on the keypad. For any questions, you may also ask a voice or a text question if you are dialed in via the web. (Silence). We do have a text question that just came through from Mr. Adnan Farooq from Jadwa Investment, about the pricing environment, "How long do

you expect this pricing environment to last? In the past, management has mentioned disability until the first half of 2022."

Sami Safran:

Yeah, good afternoon, gentleman. Probably, to answer the questions, I'd like to bring you back a little bit in the business quarters. We have noticed, since the end of Q4, 2020, a balance between, and a supply and a demand, more to the favor of the demand, while inventory went low after the pandemic. Progressively, we have seen an extensive growth in the demand while the inventories was in the lower scale, and that really drives the prices to go higher and higher.

Sami Safran:

Earlier in the Q4, 2021, we have anticipated a stability in the prices, driven by growth in the inventory. However, it is very clear, it's quite some time we have seen the major logistic disturbance through a shadow in the supply and the demand, where the material is available, but the problem was in the supply. Early of the month, we have seen the geopolitical disturbance happened by Russia, which drive the energy prices very high. It is known in different industries, energy prices is one of the major pillars, especially in the manufacturing areas, like Europe. Earlier, our outlook was expecting a flattening in the prices in the Q1, Q2, however, looking to the situation right now, we anticipate that the healthy demand and the healthy prices will continue at least, for the first half of the year.

Operator:

Thank you very much. We have another question from Mr. Sean Ungerer, from Chronux Research, "Good afternoon, gentlemen. Please would you provide some extra color on the growth initiative, versus, what type of returns are expected to be generated in those initiatives?"

Sami Safran:

I would avoid really, answering the second part of the question. But regarding the first part, I think more than one year, MEPCO has announced our strategy growth that has been approved by the board and our execution. During the initial year of 2020, we have announced our expansion in the tissue project, where it is exceeding now, halfway through. Looking for the potential commercial startup, sometime in the Q1, 2023. In addition to that one, we have launched the first BD agreements with the Jeddah Municipality. We launched [foreign language 00:09:13] to support the business of the recycling, and to secure the raw materials for the supply.

Sami Safran:

We have anticipated earlier that, coming to the tissue part, there is a major gap between a supply and a demand inside Saudi Arabia. Saudis are importing more than 60% of our tissue demand bought. We are targeting to cater to gather that requirements by the growth in the tissue industry. We have spoken earlier about the container, both supply and demand, and it's very clear, Saudi Arabia are still importing an average of one third of our need of container bought from the global market. In addition to the ability, we are exporting 40% of our production to the market.

Sami Safran:

We are seriously now reevaluating our strategy plans. Because, with the healthy supply and demand that's happening with the new legislations launched by Saudi Arabia, from the waste export regulation, from the technical specifications of labor industries, through the support that we've seen in our

industries, I think probably, we are going to hear some proposing of our strategic movement, which we'll be announcing it at the right timing.

Operator:

Thank you very much. We have a follow-up question with regards to prices, "Have you increased your prices during the fourth quarter of 2021? As well, can you please highlight any price increases expected during the Q1 of 2022?"

Sami Safran:

Since the beginning of March, we have seen in Europe, two major movements. One of them is announcing for interrupting operations, due to the major escalation of energies. I have seen also some announcement regarding the container for the prices, which is our segment, with an average of \$100, \$150. Definitely, here in MEPCO, we are studying the situation carefully, and we will announce once we have actually felt that there is a demand of an increase and there is a clear acceptance from the market. Because, usually, when we make any announcements, we make sure that we pass it to the market without a major turbulence.

Operator:

Great. Thank you very much. We have another text question. This is a follow-up, "For the year ahead, container markets are likely to be robust and tends good for pricing. A lot of European producers are facing significant headwinds from energy costs. Could you share any insight around your cost position for 2022? Thank you."

Sami Safran:

A major part of that question, we have answered it earlier. Like what I mentioned, the energy turbulence is impacting greatly in Europe. And like what I mentioned, we have seen some European mills are announcing increases between \$100 to \$150. Even from the international market, we have received some demand from Europe, and recognize the quality producers and our competitiveness. However, the logistic remains a playing factor on the subject. Like what I said, I think definitely, the local market will be benefiting out of this increase in the energy cost, but probably, we will take that decisions in a very conscious basis.

Operator:

Okay. Thank you very much. We'll do one final reminder for any additional questions. We'll give another 30 seconds or so for any additional questions. Thank you. (Silence). Okay. We are seeing no further questions at this point. I'll pass the lines back to the management team for the concluding remarks.

Sami Safran:

Well, number one, thank you very much. I equal my colleague, Bassem, about the performance of the company during 2021. Definitely, it's great to be well prepared for the opportunity to come. I would like really, to emphasize that in the past three years, MEPCO has extensively worked into improving the performance of the business, in term of utilization of operating capacities, and optimizations for operating.

Sami Safran:

We created different milestones, in term of direct material consumptions, including the water and starch. In addition to that one, we have actually positioned ourselves well into product diversification. We have also positioned ourselves into a geographic distribution. We have announced last year, that we have exported our volumes up to Canada, which is actually considered to be a great add-on value to us. While doing that progress, we actually could capture the opportunities of the healthy market improvement, and healthy prices demand, and has been reflected into the cost.

Sami Safran:

From a regulatory point of view, earlier of the year, the National Waste Center announced a control into the waste paper export, because there is an actual demand. If anyone is monitoring the emphasis of the waste paper sales, earlier, we used to benchmark our local market prices with the South Asian prices, which was in the higher side. Today, I could see that progressively, we are coming closer to our peers, which is North America and Europe, where the raw material prices in the local market is coming closer to that one. That definitely creates actually, a great benefit to the bottom line that we are in right now.

Sami Safran:

Additionally, SASU has launched and enforced the technical specifications of paper, which we believe such regulations will help actually, to eliminate, we call it, the low quality competition, coming from different regions, and to invade our market. It creates barriers.

Sami Safran:

Finally, we have already announced earlier of the year that, a second anti dumping case opened for investigation, and it is in progress right now. We expect to hear some result within a month from now, which until now, most of the indications shows a concern that there is dumping activities. We, and MEPCO here, are looking after, we call it, a fair conviction in the market. We are not after the privilege, because if we are having any privilege, we will not be able to export 40% of our sales outside.

Sami Safran:

We anticipate a healthy Q1 and Q2 progressively, like what we mentioned. Looking into our efficiency in our operation, the supply and the demand side, and definitely the logistic position, where Saudi Arabia are located with. Gratefully, more than 70% of our sales is in inland transportation, whether inside Saudi Arabia, or in the nearby region. That helped a lot really, to mitigate the exponential increase in the freight cost. Definitely, we have been hit from other areas, but we managed to maneuver our sales, selecting the least affected geo traffic spot. And accordingly, we managed that one.

Sami Safran:

Thank you very much for your trust. Thank you very much for your confidence. I would like to open for any further questions or comments.

Bassem Elshawy:

I think we have two more questions.

Operator:

Thank you, [crosstalk 00:17:10]. I think we have two additional questions, so thank you very much for the opportunity. I think some of them were partly answered. The first one is regarding costs once again,

"Have you experienced any major increase in costs, including your purchases from local players, municipalities, as well as imports? Also, it would be very helpful if you could highlight any increase in labor costs."

Sami Safran:

Let me just read the question again.

Operator:

I'll read the question once again. Follow-up question from Adnan Farooq, from Jadwa Investments, "Have you experienced any major increase in your costs, including your purchases from local players and municipalities, as well as imports? It will also be very helpful to highlight any increase in labor costs."

Sami Safran:

Okay. Regarding the second question, regarding the labor costs, no, there is no increase. Because, as all of us aware, MEPCO have launched an institute concerning training the local Saudi youth, and push them to the industry, and to other industries in the market. So the magnitude of the impact of the labor process is marginal, is not high. Regarding the direct material cost, if we break up the cost structure of MEPCO, it is number one, the fiber, and then it comes the chemicals, and the energy, I think, is number three, if I recall things well.

Sami Safran:

Now, regarding the fiber, MEPCO is a backward integrated company, so the majority of the fiber supplies are coming actually, from our own company, WESCO. And now we have launched [foreign language 00:18:52] by September last year, and [foreign language 00:18:55] also took, until now, 30% of the supply of the fibers to MEPCO. So, while the international prices of fibers went very high, the same impact did not cascade down to our direct material cost in MEPCO.

Sami Safran:

Regarding the starch, which actually constitute 70% at the local content here, regarding the starch, we have actually a long term from the local suppliers. Which, there is an increase, but it wasn't really high increase. There is a significant increase in terms of [inaudible 00:19:25], and in terms of other chemicals. And in terms of total cost of manufacturing, it is less than 20%.

Bassem Elshawy:

I think that's what I recall regarding the [crosstalk 00:19:36].

Sami Safran:

Yes. Yes, that's generally the question. I think Johan can comment further on the subject.

Johan van Vuuren:

Good afternoon, everyone. I'm assuming Adnan's question arises from state changes that you guys would've experienced in our SGNA. Now, other than the transportation cost, which Sami already alluded to, the step change in salaries and related benefits, as part of general administrative costs, is mostly once-off items.

Johan van Vuuren:

The first item relates to the employee share option scheme that we announced in quarter three last year, which was recorded into the PNL as of 1 July 2021, being the [inaudible 00:20:20] in itself was 10.3 million of an increase, and that's a once-off item. In addition to that, as part of the restructuring efforts, bringing in sufficient planning and whatever else, there's been, in this process, some of our end-of-service benefits that have been crystallized and paid out during the year to old members of staff. Those are the two main reasons for increases. So you can expect that during the course of 2021, the GNA would return back to normalized levels.

Operator:

Okay, thank you very much. The next question is, "Can you please comment on the difference between current prices and international prices?"

Sami Safran:

In terms of, selling prices?

Operator:

Yes, "The difference between the current prices..." I believe this is related to the local ones, versus international prices.

Sami Safran:

Well, like what I mentioned earlier, MEPCO, in the Saudi market, is an open market for a supply and a demand. Usually, in MEPCO here, we align ourselves with the international prices. If there is any increase that you will find, actually, it's only an impact of the international market, because we do not have any privilege toward banning the imports from outside. There is of course, fluctuations between increase and decrease, and classically, you will find we are matching ourselves with the international prices.

Operator:

Okay, thank you. Next couple of questions, specifically with regards to regulation, "Can you please shed some more color on the export regulation, what kind of duties one should expect as a result of the dumping hearing?"

Sami Safran:

Well, I can tell you probably, in the last anti dumping cases that we win it, that was, I think, in 2017 or '18, if I recall. The duties applied on the dumping countries was between 20 to 25% duties. Now, of course, no specific conditions has been made yet, but classically, the duties applications will be actually, the price variations between the selling market, which is Saudi Arabia, and the local market, which is the dumping country, for your information. The dumping countries who are now claiming against, is Germany, France, and India, which, they are influencing the GCC market. If there is any resolution, it will be against the three countries or at least, one or two of them.

Operator:

Okay, thank you very much. I think we have no further text questions or voice questions. I'll pass the line back to you for, once again, the final conclusion.

Bassem Elshawy:

Thank you very much everyone, for your participation. If you have any follow-up questions, please reach out. You have my contacts. My name is Bassem Elshawy]. You have my email. Happy always, to answer your questions. Thanks again. [Inaudible 00:23:46].

Operator:

Thank you very much. This concludes our conference call. We'll now be closing all the lines. Thank you. Have a great day.

Bassem Elshawy:

Thank you.