

**MEPCO – 9M 2019 Results Conference Call Transcript**  
**November 4, 2019 at 1500 KSA**

Operator:

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 IR team. After the presentation, you'll have the opportunity to ask questions. So without further ado, I'd like to pass the line to MEPCO. Bassem the floor is yours.

Bassem:

Thank you everyone for your continued interest in MEPCO. We start today's call by stating the forward looking statements. 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, that common line 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 stated in the course of this presentation. Thank you.

Bassem:

Ladies and gentlemen, Eng. Sami Al Safran, the CEO, could not attend today's call due to personal emergency. Mr. Ahmed El Fazary, the chief commercial officer will walk you through the overview of the results. Mr. El Fazary.

Mr. Fazary:

Good afternoon ladies and gentlemen. Thank you for joining us once more to discuss MEPCO's results for nine months of 2019. Our results show recovery from the previous quarter, this quarter. In response to your concern about the overall paper market condition and trends, please allow me to give you a clear view on the current situation, impact of the situation, our reaction and future expectations. The current market situation: I'll take you through a quick overview on the general dynamics of the paper markets. Basically, containerboard is an international commodity as everyone knows here, that it's continuously growing by virtue of its correlation to consumer and industrial consumption. This demand is not constant but has been carrying a historic growth rate of somewhere from 2 to 3% growth rate per annum.

Paper prices in general go through price adjustment cycles, which are driven by global supply and demand balance. It also has a seasonal factor, such as the holiday season effects like in the region here, the holidays in Europe and the States, Christmas holidays. Also, it gets affected by the harvesting seasons in different parts of the world and end of the year. A lot of season factors that affect industry and varies from one region to another.

What's the situation now? The global container board consumption has only grown by 0.1% in 2019 year to date, which is almost nothing. We haven't experienced a growth in consumption. China being the largest single country producer around the world, which is representing close to one third of the world's consumption, definitely has to play a major role in what we're experiencing today. The economic slowdown in China, forced consumption to drop, which accordingly caused containerboard inventory levels to rise worldwide, which accordingly exerted high downward pressure on pricing.

That's one thing. The economy also, I'm sure everyone also is aware that it's one of the major factors affecting the equation, with Brexit as adding another layer of uncertainty to the overall industrial outlook. This all caused a cutback in production levels. From a Saudi perspective, the recent government decision to exempt private sector companies from labour levies and the direction to fix skewed prices for 10 years seems very positive to us and we're looking forward to seeing a definitive announcement about it later to assess its impact on the business.

What's the impact of that situation on MEPCO?

First of all, please let me stress the fact that we are not worried by what we are witnessing now for the reasons mentioned just before, like the profound world demand, seasonality, all that stuff. So we believe that prices are and will correct upwards sooner or later. Our prices, whether domestic or export for export markets, adjusted downwards following the international price trends, which accordingly impacted our revenues. To share with everyone who's attending the call: indicative figures, the mid-range of 2019 market price, knocked out selling prices, was in the range of \$470 compared to \$600 in 2018. This shows a drop of over 20% year over year.

How did we react to that? We have defined major directions to offset the impact of price drops. We've grown our sales volumes, our sales volume for nine months this year reached about 310,000 ton, which is 5% higher than the nine months of 2018 volume. While competition take excessive shutdown time to offset inventory build-up, our utilization rate never dropped below 92% this year compared to 85% and below for competition. So basically, we're ramping up our sales and increasing our market share in our existing markets. We also have been working, and this is something that we continuously work on, which is, cost efficiency and I think Dr. Darweesh, the CFO's presentation, I think he will be able to elaborate more on the cost efficiencies and where we have reached and what kind of efforts we're putting.

Also, another aspect on how did we react to the situation is basically we've been lobbying for a more regulated local paper market by closely monitoring the execution of the anti-dumping regulation and conducting several discussions and meetings with governmental officials. This resulted in an ministerial decision to review all paper imports regardless of the country of origin, which means that it's not only subject to the dumping countries, it's subject to all countries exporting to Saudi Arabia in order to assess the applicability of import restrictions.

We've also been analyzing different growth opportunities carefully to select the best match according to the current situation and future growth plan. We took the first serious step towards enhancing our backward integration, an arm with WASCO, by contracting with Roland Berger, the world's leader consultant that is in charge of reforming Saudi Arabia's waste management industry.

What are our future expectations? We don't tend to make significant changes from the current situation on the near term. Yes, we look forward for a positive change in pricing in 2020. We're quite optimistic against the odds. Also, another topic that I would like to bring is PM4. PM4 project is one of the multiple expansion venues under consideration where we will announce the approved choice of expansion once we have the board resolution. Thank you very much everyone. I will now hand over to Dr. Darweesh for the financial review.

Dr. Darweesh:

Thank you everyone for joining the call. While our loss are below par compared to 2018, this quarter is the best of the[results] and shows better overall metrics compared to quarter 2, 2019. Revenue improved from 2.60% from the previous quarter although profit increased by 18.6%. Gross profit margin grew improved by three basis points to reach 21.7%. However, Saudi R EBIDTA improved by 14.5%

The EBIDTA margin reached. Up close to 1.8 basis points. Net income jumped significantly to a positive 858,000 Saudi Riyal.

Our cost control effort are being ... . Taking a closer look at increase in gross profit relative to sales revenues, we conclude that significant cost efficiencies have been achieved, which cascaded down to Net Income.

In terms of cash flow generation, we continue to generate healthy cash flow proficient for our day to day operating expenses as well as meet the debt obligations.

We have negotiated with the bankers to refinance extensive loan carrying the higher interest rates to minimize financing cost, manage to refinance 106 million of Saudi Riyal our medium term loans by lower cost level. Regarding the financial labour tax exemption and now announce earlier. This will translate into savings off a 500,000 Saudi Riyal. In the first quarter 2019 and about 2 million annually for the duration of the coming five years.

The economic situation our collection rate was very healthy, which resulted in creation of new account 12% of 2019 compared to December, 2015 we are looking forward to ending this year on a positive note. Now I will handle to operator to start the Q&A session.

Speaker 1:

Thank you very much. So ladies and gentlemen, we will now start the Q and A session. If you have any questions, please can you press five star on your telephone and listen carefully for the line un-muted command. That's five-star. Thanks.

Speaker 1:

So just give it a minute or two. So we do have a question would the caller mind just announcing their name beforehand please. We haven't picked it up here so if you can go ahead and ask your question. Thank you very much.

Speaker 7:

Yes. This is Abdullah from ?? financial, I want to ask if you could shed some light on the anti-dumping case. Because today we saw the anti-dumping case for ceramics. They just issued an announcement if there are any updates regarding the anti-dumping case that happened previously.

Mr. Fazary:

Yes. I will the answer you, the anti-dumping case. The final resolution has been out already and we announced it and it's under implementation now by different GC government to implement it at the customs authorities. But the ruling is out and it's in our favour and duties, don't think duties have been imposed if I recall the numbers correctly from 24% up to 30 plus percent. So that's the latest updates on the anti-dumping and just to add to that part because

our case was very strong and was handled professionally, the GCC technical office who was investigating in the case, they invited our MEPCO in one of their workshops to represent our case as a model for other companies in the region who are interested to file new case.

Speaker 7:

Okay, great. Can I just, I have another question regarding the local and export sales. We see that there is a growth in exports the first nine months of 2019 compared to 2018 can you explain why the export represents much higher or at least higher than the previous year?

Mr. Fazary:

Our exports this year has increased because as I mentioned in the production that in general we increased our sales, our total sales plus when the market goes through changes, it is companies who are prepared with export markets, with a night press in different markets and a wide range of diversified coders. It enables the company to achieve what we have achieved, which is increasing our sales and to keep the right balance between the domestic market and export market.

Speaker 7:

Okay. Thank you so much guys.

Speaker 1:

So any other questions please press five star on your telephone. Thank you. We'll give it a minute or two. Hi. So we have a question from Amer from ??. Please go ahead.

Speaker 8:

Hello?

Speaker 1:

Yes, please go ahead with your question. Thank you.

Speaker 8:

Hello?

Mr. Fazary:

Hello. We can hear you.

Speaker 8:

Okay. I have a Question, could you share with us your prospective for the industry in term of the pricing for the fibre. That's one thing, and the cost of the raw material. How do you see it within the short and medium term how do you see the industry in terms of those two indicators.

Mr. Fazary:

But look, let me ... on the costs, the costs then I'll take you to the pricing of the encoder. Costing of the raw material, everywhere around the world is under pressure, which is in our paper and we are continuously working on utilizing this and this is due to China case as we discussed in a previous calls. So there is no balance between demands, there is surplus of supply of raw material and we believe that this should continue on a longer term because it seems to us until this very moment that China are still continuing with their very strict measures on weight paper inputs, which would leave us with a lot of weight being offered

around the world. And when we come to pricing the encoders, we definitely it's all a forecast and we can give any forward looking but based on how we see things as mentioned in the introduction, we're quite optimistic that next year should be positive when we can't identify it. But we're quite positive about next year.

Bassem:

Dr. Darweesh if you would like to add -

Dr. Darweesh:

For raw materials, raw materials especially fibre, this year. Fiber dropped this year by about a lot here by about 40% but not in that same level of drop in sales, sales of should drop about about 23% or 24% we expect prices will go lower than the current status now because of the government, Saudi Arabia government started to regulate with with the management in Saudi Arabia to be in the same level of the United States and Europe. This would increase the availability of raw materials and take prices down. For example, this year the export of raw material both to the lowest level compared to the last year and year before the last. We expect first, the reduction in fibre prices in 2020 and onwards.

Speaker 1:

That's great. Thank you very much. Any other questions? Just a reminder, please press five star. Thank you.

Speaker 1:

Hi. We've got another question, and can I ask the caller again just to announce themselves when they ask the question, please go ahead and thank you very much.

Speaker 1:

Yep, please go ahead. I think someone just joined and asked a question. So if you're able to just announce yourself and then ask your question. Thanks very much.

Speaker 9:

Yeah. Hi, this is Ashared Saline from Saudi Kuwaiti Financials. I'm not sure if I missed something or not. I just wanted to get some update regarding the expansion by MEPCO. Could you please share a little bit light on that and in terms of fuel supply, how was the outlook over there? Thank you.

Mr. Fazary:

Okay. If you're referring to the post production line team four, management didn't have intention to grow but it is carefully looking at the timing of carrying on with the project in light of all the changes that are happening on the Saudi soil, the regional, geopolitical changes and the world economic situation, it might not be the best time right now to announce the commencement of that project. So we are taking an extremely prudent approach to committing to start such huge investments that can exceed 1 billion Saudi Riyal. This is to safeguard and protect the shareholder interests in the third stand. So this is something that is management is taking extremely cautiously and seriously, but the intention of the company to grow have not changed and it's been on. We are investigating a number of other possibilities of growth in different directions that could be more suitable to the current situation.

Speaker 9:

Thank you so much. Thank you.

Speaker 1:

Thanks very much. Yep. So we'll give it another couple of minutes. So anyone wants to ask a question, please, five-star on your telephone. Thanks very much.

Speaker 1:

Yep. So we have another question from Amel from Solon Bassett, so please, please proceed, Amel, thank you.

Speaker 5:

All right, in terms pricing of the final product as well as the quantity Q3 compared to Q2 is it higher or lower? The price and the quantity.

Mr. Fazary:

Sorry, I didn't get your question. What's higher?

Speaker 5:

Comparing the price of the items sold and the quantity sold Q3 in 2019 compared to Q2 2019 is it higher or lower?

Mr. Fazary:

Dr. Zareesh?

Speaker 5:

Q3 as opposed to Q2

Mr. Fazary:

In terms of volume, the volume is higher in Q3 opposed to Q2.

Dr. Darweesh:

In terms of price, the price dropped by four percent compared to the second quarter.

Speaker 5:

Sorry, again?

Mr. Fazary:

The price dropped by about 4% opposed to Q2 and volumes went up by about the same percentage.

Speaker 1:

Okay. We have one more question from Mr. Saleem, please go ahead. Thank you.

Speaker 9:

Yeah. Hi, just a question about the utilizations. I wanted to know how exactly was the utilization in this quarter and going forward, if we see global demand being very vague and pressure on product prices, is there a possibility for MEPCO to somehow reduce the utilizations and try to probably operate at a much lower level than what they used to and probably, I mean somehow increase the bottom line in that regards. Is that a possibility or we don't have that partial luxury over here.

Mr. Fazary:

To answer your question about the utilization rates, the utilization rate throughout this year has been over 90%, which is quite high compared to most other mints. It is an option to reduce our utilization rate. It is an option, but it's a company decision, which direction we want to take and we're choosing to utilize the current situation to maximize our utilization rates, maximize our sales and pave the ground for ... to have a larger market share and pave the ground for the future when prices pick up.

Dr. Darweesh:

This also will decrease fixed cost if you decrease the authorisation rate the fixed rate will start to increase. That why we are very keen to ?increase productivity? as much as we can to the degree it's a possible

Speaker 9:

Thank you.

Speaker 1:

Thank you very much. We have one more question. And again can I ask the caller just to announce their name and where they're from at the start of the call? Thank you very much.

Speaker 10:

Yes. Hello. My name is Adrahman Abarri our friends at B Capitol. My question is what's your guidance regarding the expected top line growth for 2020 you know, regarding sales growth margins quantity sold.

Mr. Fazary:

Okay. I'm sorry I didn't get your name. Can you repeat that?

Speaker 10:

Yeah. My name is Adrahman.

Mr. Fazary: Okay. ?? Okay, welcome. Thank you for asking. We are very cautious when it comes to forward looking projections in terms of the current changes of the paper market now. It can be quite unpredictable but we are following the situation very closely on our quarter to quarter basis. So giving full year expectations is going to be extremely misleading now. But for now we are following the same trend that we have been witnessing for the past three quarters and we asked you to follow the same data as well.

Speaker 10:

Okay, thank you.

Speaker 1:

Okay, thank you very much. So no more questions. So ... sorry, we've got one more question. So it's another question from Ahmed from Sulam Baseed. So Ahmed please proceed with your question. Thank you.

Speaker 8:

Hi, again, I want to ask if WASCO would benefit from the government decision to exempt from the foreign from ??? fees because it's only for industrial. When I see the activity of wall codes it seems industrial but when I check, registration was not industrial. It has a huge expat

manpower. So does it benefit from that or no?

Dr. Darweesh:

Yeah. Is there benefits? Okay. If people ?? MEPCO because ?? manufacturing six of those, only the total in that, annually total in that about 2 million for the first quarter. But it will be 500,000 for one quarter? But for WASCO as you mentioned for the time being it's not as much manufacturing company. We have corporate alliance we are in the correspondence with the government what is the company manufacturing or ????. We didn't receive any feedback until now.

Speaker 5:

So this ?? for MEPCO for WASCO it is still in discussion.

Bassem:

For the time being and that's for MEPCO only

Speaker 5:

When do you expect to receive the answer from the government? Is this, is there any time frame and will you announce that once you receive that information?

Bassem:

Well once I receive information, I would announce it.

Bassem:

But there's no specific time frame

Speaker 1:

Okay. Thank you very much. So we have no more questions so I'll hand it back over to Bassem for closing remarks. Thank you very much.

Bassem:

Thank you. All right. Thank you very, very much everyone for attending the call. If you have any other questions, please contact us by email or phone. We are stand by to receiving the question and we look forward to talking to you again when the year end is on. Thank you.