

# MIDDLE EAST PAPER COMPANY

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## CONFERENCE CALL DEDICATED TO MEPCO FINANCIAL RESULTS 1Q 2022

**Company:** MEPCO

**Date:** 12.05.2022

**Participants:**

- Eng Sami Safran, Chief Executive Officer
- Mr Johan van Vuuren, Chief Financial Officer
- Mr Ahmed El Fazary, Chief Commercial Officer

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Alia (00:51):

So, good morning, good afternoon, and good evening everyone. This is Aliah El Mehelmy from CI Capital, and we're very glad to be hosting Middle East Paper Company's first quarter 2022 results conference call.

Alia (01:07):

From MEPCO's management, we are joined by the Group President, Mr. Sami Al Safran as well as the group CFO Johan van Vuuren. I hope I pronounce that correctly, as well as the company's Chief Commercial Officer Ahmed El Fazary.

Alia (01:23):

I think we have most people connected now who have dialed in so far. So, I'll now hand over the call to Mr. Sami. You will provide us an update on the company's Q1 performance, and then we'll open the floor for Q&A. Mr. Sami, please go ahead. Mr. Sami, your line is open, but we cannot hear you.

Sami Al Safran (02:55):

Yes. Can you hear me now?

Alia (02:59):

Yes. Now we can hear you. Please, go ahead.

Sami Al Safran (03:02):

I'm sorry, Aliah. I've been doing the introductory. I'll do it again. But good morning, good afternoon ladies and gentlemen, and Eid Mubarak to all. Happy to share with you our Q1 result for 2022, which came similar and in certain levels even slightly better than Q4.

Sami Al Safran (03:24):

It's a result of our expectations for the business performance regarding the total business in the packaging industries, a healthy demand backed up by available supplies of the raw materials. Some favorable environmental changes that helped really to grow their business. And you could see, although the net financial result is a slightly lower than Q4 due to some minor logistic challenges, but you could see most of the ratios are more healthier than Q4, not only in terms of selling the prices, but in terms of also the cost control of our direct materials, most of the variables been becoming a control.

Sami Al Safran (04:12):

I think the only challenge we faced it was regarding the logistics which has been overcome in Q2 and probably once we announced, inshallah, our result, we are going to see it, how it's been mitigated.

Sami Al Safran (04:25):

From other side of the business, the tissue project are moving as a planned. We have received some of the equipments for installation. Some of the factors have been conducted in last quarter. Civil is working progressively on executions. As expected, we will be starting the commissioning and starting in Q1 2023. Hopefully by early Q2 will be in a full commercial production.

Sami Al Safran (04:53):

Regarding WASCO performance, it remains the same in term of supplying raw materials. We capture the advantage of the regulations of Saudi Arabia regarding controlling the raw material export that puts us not to lose the control or the grip and to the direct material cost and help us actually to deliver a stable result as we have seen it. Meanwhile, without spending long time, I would like to leave the floor back to you and open for any Q&A.

Alia (05:29):

Great, thank you. So, anyone who has a question may type it in the chat box or raise his hand and I will unmute the line.

Ahmed Mahmoud (06:10):

Okay. Thank you, Mr. Sami, for your insights on the first Q results. Can you please elaborate on what happened on the volume side, in terms of the recent logistical challenge. Did the company experience any drop in sales volume?

Ahmed Mahmoud (06:36):

And I can see also that the local sales versus export sales have decreased, the export, you were exporting in Q4 like 40% and it has been decreased to 37%. So, does this increase comes from the lower exports or is it due to the logistical challenges? Thank you.

Sami Al Safran (07:08):

Thank you. I will give the answer to Mr. Ahmed, our Commercial Officer, to answer that two questions.

Ahmed El Fazary (07:16):

Answering your last question about export drop, opposed to the previous quarter, yes, there has been a drop, but it has been partially uncontrollable due to the logistics issues.

Ahmed El Fazary (07:34):

But also it works in the direction that we have been intending to go for, which is to increase our local sales because there's definitely a much bigger opportunity to sell in the local market, amidst the challenges, the competition from a broad facing to supply goods to the local market. The first question was? Can you repeat please the first question?

Ahmed Mahmoud (08:09):

Yes. Sure. Did the logistical challenges that the company experienced affected the volumes sold, like your exported less volumes than Q4?

Ahmed El Fazary (08:23):

As I just mentioned, yes, it had an affect, but in a positive manner and we have a very, very dynamic sales strategy where we are able to shift very smoothly between markets, whether it's export markets or domestic market, and there's a big demand in the domestic market that we are very happy to cater for.

Johan Van Vuuren (08:54):

Ahmed, if I can just add to that, the reduction and the dispatch rates that were communicated in the earnings release largely related to the turbulence in Europe. So, through the redirection of the sales that Ahmed just mentioned, managed by the commercial team that has been redirected and the recovery is already back on track.

Johan Van Vuuren (09:19):

We are selling back according to plan since the beginning of quarter two, and gradually during the course of the year, the dispatch that has been reported in quarter one will be fully recovered.

Ahmed Mahmoud (09:31):

Okay. I'm sorry. I have another follow up question regarding this point. You mentioned that in Q2, these logistical challenges have been overcome by the company. So, do we expect any effect of these challenges to the end of the year or it just ends with Q2?

Ahmed El Fazary (10:01):

Look, definitely part of the logistics challenges are being overcome, where we would be able to shape to certain destinations that we face some difficulties in exporting to. But we still follow the same strategy of enforcing our sales to the domestic market and nearby markets.

Ahmed El Fazary (10:24):

Regarding our vision, how do we see this continuing for the rest of the year? Of course, it's very difficult to anticipate, but it's quite clear that it should continue with us until the end of the year.

Sami Al Safran (10:43):

Ahmed, if you allow me to elaborate more in your questions, because I understand the concern you have is that the logistic turbulence might negatively affecting the business. And the answer is to let you know more about us.

Sami Al Safran (10:56):

In term of sales transportation, almost 80% of our sales is by inland transportation, whether it is inside Saudi Arabia or in the nearby country. The remaining 20% plus and minus, which is the sea freight transport sales, and that comes to the Europe, Africa, North America and the far Asia.

Sami Al Safran (11:21):

So, if there is any logistic disturbance we are talking about, we are talking about the remaining 20%, which we have reported early of the quarter, and we have clearly mentioned that this challenge has been overcome in the second quarter for the very simple reason that MEPCO in the last 20 years, we are actually diverting ourselves between 60% local and 40% export.

Sami Al Safran (11:46):

So, the level of knowledge we have regarding agility in movement and adopting ourselves to the change environment is very high. It is a challenge but it's never been a problem to us.

Ahmed Mahmoud (12:01):

Thank you. So, giving the lower export potential is it doable that we assume that total sales volume will be flat year over year during 2022?

Sami Al Safran (12:11):

To a major extent, the answer is yes. As you can see, we are a manufacturing facilities. We have reported our production results in the previous years. And you could see we are performing in 10 similarities and due to our nature of business, that we are 24/7. We tend always to execute sales and have orders on hand for quite some time, so we can maintain smooth operation of our business.

Ahmed Mahmoud (12:44):

Okay, thank you.

Sami Al Safran (12:54):

Yeah. There is the questions in the Q&A chat about how did utilization change year to year and quarter to quarter. Look, in paper industry, usually we maintain our operational efficiencies for the business above 90%.

Sami Al Safran (13:10):

And usually if there is a major change in the business environment, like what is happening, for example, the latest crisis, the geopolitical disturbance in Europe, where energy costs went up very high that

forced the people to reduce their operating rate or because of the pandemic situation where paper mills bring down their operating rate at the level of 85%.

Sami Al Safran (13:33):

In our case, in MEPCO, through the history of the business, we never came down below 90, even due to the global crisis in 2009. We kept our operating efficiencies at higher for the objective that this is the business strategy we maintain. We always maintain our flow. We control our fixed expenses. And by this, we can adopt ourselves with the business up and down.

Sami Al Safran (13:56):

So, answering your question, is there a change? The answer is no, there is no change. Rather, if there is a major announcement in term of an investment or growth, then that will impact our operating efficiencies in term of volume.

Alia (14:13):

Great. Thank you. Saleh, your line is open. Please go ahead.

Saleh Alamro (14:23):

Hello, everyone. And happy Eid for you all. Thank you for the insights, and I would like to ask a question about the prices, paper prices per ton. Is there an increase in the paper prices per ton comparing Q1 to the Q4? And what's your look for the prices during the 2022?

Sami Al Safran (14:46):

Thank you, Saleh. Well, regarding the increase, the answer is yes. And you could see it from our financial result, which has been reported. The sales margin went higher.

Sami Al Safran (15:05):

The outlook of the year, we have announced it in our quarter result. We anticipate a healthy performance for the Q2. There is no indications of stagnancy or downward. The trend rather, the geopolitical disturbance happened due to the Ukrainian war.

Sami Al Safran (15:22):

The major turbulence in term of logistic disturbance is actually stimulating the commodity prices to remain in the higher level. So, we do not anticipate for Q2 to see any price reduction. Rather, you might see some price increase. We usually announce the increases if the increase is significant, but if it's a minor, we do not announce it.

Saleh Alamro (15:48):

So, if you allow me to follow up question, the increase between comparing Q1 to Q4 is the single digits?

Ahmed El Fazary (15:57):

I don't think we can give ...

Sami Al Safran (15:58):

Saleh, if you will divide the sales into the volume, you could see definitely is not a single digit increase.

Saleh Alamro (16:16):

Okay. Thank you.

Alia (16:18):

There's another question in the chat box.

Sami Al Safran (16:34):

Okay. There is a question from Ghadi El-Ghamdi about what is your saving strategy plan and how can help face the changing in the market now?

Sami Al Safran (16:43):

Well, I think this is very good question, Mr. Ghadi. Actually, in the past two years during the challenging situation, we have announced MEPCO our strategy in term of efficiencies, improvement, and term of cost control.

Sami Al Safran (17:00):

And you could see it very clearly while the selling prices went extensively very high, that the manufacturing cost has not been really responded accordingly due to the different initiatives that we have taken it in the business to maintain it, and our idea actually is to reach the sustainability business performance, not only in the good days, but also in the bad days.

Sami Al Safran (17:22):

So, I see what is happening now is actually only a translation [Arabic: thank God] for the strategy that we have taken it two years ago. And now we are in a quite fair, solid ground regarding the business performance.

Sami Al Safran (17:40):

I have answered this question earlier by the people. Some of the people think that the majority of the financial result delivered by MEPCO was solely due to the sales prices and the answer is to a certain extent, yes, but I could guarantee you that at least one third of it happens due to actually the efficiency programs we have applied in term of a direct material cost, direct manufacturing cost.

Alia (18:18):

Thank you, Mr. Sami. There's a second question from Ahmed in the chat box. He's asking, given the recent price rally in 2021 and going into 2022, do we see risk of a demand pushback this year on higher prices?

Ahmed El Fazary (18:36):

I'll take this question. We'll almost halfway through past this year and looking at the remaining of the year, we don't see a major risk in drop of demand. Demand has been quite healthy, so we expect it to be fairly going on, especially that we are approaching high seasons here in the region and in Europe with the summer season.

Alia (19:17):

If there [crosstalk] Sorry, go ahead.

Ahmed El Fazary (19:21):

Go ahead please.

Alia (19:22):

I was just going to check if there's any more questions, please raise your hand or type them in the chat box. Maybe in the meantime, one from my side, if I may just an update on the new waste law in terms of its impact specifically on OCC prices domestically.

Sami Al Safran (20:04):

It's a good question Alia. Look, in the past two decades, when we were operating our business in Saudi Arabia here, if you compare the raw material prices, OCC on a specific compared with the European, American prices and compared with South Asian, you will find in a simple manner that while the prices in Europe at \$100, you will find it in Saudi Arabia, here is at \$200, whereas in Asia is at \$300.

Sami Al Safran (20:37):

And the reason of driving this high price is actually the increase of demand in Europe, in the South Asia, which actually offset it only by the shipping cost. And that was creating really a big burden on us that we used to have a major challenges, especially at the downward trend of the market.

Sami Al Safran (20:59):

Thankfully, Saudi Arabia five years ago announced the ambition of the waste management. And one of the major ambition was by 2035, a full diversion of waste from the landfill, 80% recycling and 20% to waste to energy. Seeing the recovery rate of OCC in Saudi Arabia, it is not the best in the world, but it's okay. However, that creates actually a challenge in a shortage and a cost.

Sami Al Safran (21:28):

Now, since last year, the National Waste Center has announced regulations in term of licensing the export of the waste paper to make sure that local melts are satisfied before they allow for any export. And we have seen it for the first time of the history of the waste paper in Saudi Arabia, that we have detached from the index of South Asian and start to get closer to the index of United States and Europe.

Sami Al Safran (21:56):

And now locally, you will find the local OCC prices in Saudi Arabia is similar to European and American countries, which gives us really a competitive edge to compete and defeat the conviction from outside. And that is which I mention it that a sustainable performance growth in the business in term of that sector, we believe with the progressive implementations of the waste management strategy in Saudi Arabia, it'll create more availability, it'll improve, even in term of the reducing the cost of the direct material and improve the bottom line of our business.

Sami Al Safran (22:35):

That's probably the area related to the direct material course for, of course, for WASCO. It opens a lot of room for us. You might have heard that last year, we had announced a first private and public partnership between WASCO and Jeddah municipality. We have established a company called Estidama. The business is similar to what WASCO except to covering a bigger domain in terms of investment in a different waste management sector.

Sami Al Safran (23:08):

We have kicked the business in last year, September, and it is growing up on the plan. Delighted by I think the new year probably will cap into different business angles.

Alia (23:27):

Very clear. Thank you. There is a question from Abdulrahman in the chat box. So, what's the outlook and volumes for Q2? And is the company affected by the current inflationary environment?

Sami Al Safran (23:48):

Can you repeat please the question for Abdulrahman?

Alia (23:55):

His line is not open. He needs to request it. Abdulrahman, I've opened your line. Otherwise, I'll repeat the question. The first part is what is the outlook on volumes for Q2?

Abdulrahman Al Obaikan (24:12):

Can you hear me?

Alia (24:14):

Yes. Can hear you.

Abdulrahman Al Obaikan (24:14):

Yes. I just want to ask what's the outlook on volume for the import, and also is the company affected by the current inflationary environment with costs going up almost across every industry. So, I just want to know if the company affected in these times.

Ahmed El Fazary (24:38):

Let me take the first question and I'll hand over the second question to Johan. The first question we are expecting better performance in terms of volumes, opposed to Q1. I think this is all what I can tell you as an indication. The second part, Johan.

Johan Van Vuuren (25:02):

The second question for Ahmed.

Ahmed El Fazary (25:12):

The product mix then I'll handle the product mix for Q1. It's almost the same. Thank you.

Johan Van Vuuren (25:29):

Okay. Abdulrahman, let me get back to the second part of your question with regards to the inflationary environment. So firstly, with regards from a business perspective, Ahmed's already discussed our outlook for the remainder of the year.

Johan Van Vuuren (25:44):

For sure, from a demand side, we expect to see an impact at some point towards the end of this year, but most definitely at the moment we haven't seen any impact flow through. In terms of the financial impact of higher inflation and accompanying higher interest rates, look, we've done a sensitivity based on our current debt levels, but I think it's worthwhile that I answered the question twofold.

Johan Van Vuuren (26:11):

So, during the year end or annual report release, you will recall that I've mentioned some of the debt restructuring and consolidation efforts that we've been going through. So, from a debt perspective, we focus not only on consolidating our debt, but also drive down the absolute cost of our debt.

Johan Van Vuuren (26:32):

In addition to that, with further interest rate increases, all things being equal, we expect that the rising interest rates probably for every half a percentage point to increase our interest rate cost or our finance charges per quarter of roughly between 430 and 450,000 riyals per quarter.

Johan Van Vuuren (27:02):

So, there's not a material impact. I don't believe that investors will even see a material impacted because the impact that I've mentioned excludes any repayment of our existing debt, which is something that we continue to strive towards reducing. We believe that the current data equity ratio is more or less on par to what we would like to see in the company, excluding obviously, future project finance for growth. But as far as interest rate costs, increases concerns that's more or less it.

Johan Van Vuuren (27:35):

As far as other inflation goes, given our fixed cost, you've seen the P&L for the last quarter, the increases other than the variable increases on GNI costs have largely been reflected. So, we don't foresee any further material impact.

Johan Van Vuuren (27:55):

However, that being said, obviously, inflation costs on other raw materials other than our fiber, chemicals and other variable costs. We are keeping a close eye on that.

Johan Van Vuuren (28:06):

And back to Ahmed's comment on agility with regards to our product mix, we make sure that we redirect into other products if we see that imported cost or imported inflationary cost elements are getting out of the norm based on our current and expected sales mix for the year. Does that answer your question?

Abdulrahman Al Obaikan (28:33):

Very clear. Great. Do we have any more questions on the line

Sami Al Safran (28:56):

All right. If I may comment for the different questions regarding the concern into the different business environment. It's worth mentioning gentlemen that when we established MEPCO two decades ago, we established it in a very challenging environment where water was not available, raw material, which is fiber forestry is not available.

Sami Al Safran (29:24):

And accordingly we manage really to grow the business and bring the Saudi Arabia to be one of the largest producer of paper industry in the Middle East. And now what we can see out of the experience of the two decades now, the business environment in Saudi Arabia becoming very appealing in terms of a new regulations happen.

Sami Al Safran (29:48):

You might be aware that we have launched for the second time. The second anti dumping case, the preliminary report came to the favor of our case against the three countries: India, Germany, and France, which is one of the largest three exporters to the market.

Sami Al Safran (30:08):

We were only keen to create a fair business environment in the region here and we can grow of what e have our presence across the globe in almost 50 countries. We have been distinguished by the quality of product that we have. And this is why we've been very receptive in different areas, including the mother of the forest industries like Canada, for example.

Sami Al Safran (30:31):

So, I think, yes, what is happening nowadays in term of business it's considered to be challenging from one end. But from the other side, it's considered to be a great opportunity for us because... And I remember last year when the commodity prices went very high, personally, I was under the impression by the end of the year of '21 things should soften down, but then objective is being stimulated by the major turbulence in the supply chain.

Sami Al Safran (30:59):

And then the geopolitical disturbance that even boost the commodity prices higher and higher, and we are making a good utilization out of it, which I think we are hoping that the 22 years will be one of the good years also for MEPCO and whoever our shareholders with us. We will really try to bring them a better value of what we are doing right now. And again, thank you very much for your confidence on ourselves.

Alia (31:35):

Thank you Mr. Sami. I'm just going to do one round of checks in case there's additional questions on the line. Please raise your hand or type it in the chat box.

Alia (31:47):

Maybe in the meantime, I'll just give a chance for people to submit their questions. Johan, I wanted to ask if barring, obviously, any project finance for potential expansions, when do you think you can turn

net cash? Given the reduction in gross debt that we saw in the first quarter, and obviously, the big improvement in cash as well, given the rally in prices.

Johan Van Vuuren (32:19):

Well, Alia, can you just clarify the question? So, when we would turn net cash.

Sami Al Safran (32:25):

Exactly.

Johan Van Vuuren (32:28):

So look, I need to fully comprehend the question. If you look at our cash flow statement, are you referring to the cash flow from investing and financing activities compared to our operating cash flows? Which is already positive, correct?

Sami Al Safran (32:53):

Correct. No, but I'm referring to the balance sheet. So, basically when will your total cash and equivalence exceed your total debt, excluding any sort of project finance?

Johan Van Vuuren (33:06):

Yeah. So, look, let me take this piece by piece. So, the cash and cash equivalence on our balance sheet already was higher than what we expected or what is normally the case, and this was for very clear reasons.

Johan Van Vuuren (33:23):

So, at the end of December, we refinanced the series of loans through the SABB facility that was announced in late December. So, in that we raised the series of cash and started settling the loans.

Johan Van Vuuren (33:40):

Now the cash flow balance of 149 million that you see in the balance sheet is actually higher than what would normally be the case. And we would actually drive that down to more between 50 to 70 million, obviously, from an investment perspective, we want to ensure that we keep that sensible. At the end of the day, we want to ensure that we return money to the shareholders rather than just keep it on the balance sheet.

Johan Van Vuuren (34:09):

So, what we aim to do is by the middle of the year, the cash flow balance would actually further reduce following the last series of debt consolidation and rescheduling. So, with all our rescheduling, it has been accompanied by a grace period of one year. So, you will not see a significant movement in MTLs. Other than that, which you will see in quarter two, given that we've rescheduled the debt after publishing or after quarter close. So, you will see very little movement in MTLs.

Johan Van Vuuren (34:47):

However, you will recall in our annual report, there was a dividend of one riyal per share recommended, which will be put forward for approval to the shareholders on the 13th of June, and some of the cash in

our balance sheet is obviously reserved for that. The remainder of the cash flow is making sure that although we have access to debt, we want to ensure that we put that cash to best use, and we will apply that cash for our growth projects.

Johan Van Vuuren (35:17):

So, if you look at the current total debt portfolio, all of our debt amortizes between 2023 down to 2027; however, that being said, just going back to your initial question, we do not plan to finance the business entirely with equity. We don't think it's a very efficient capital structure. So, the data equity ratio, as I mentioned, which you've seen in Q1 2022 of around 42% is for us healthily enough, given the cashflow from operations that we generate.

Alia (35:55):

Okay. That's very useful. Thank you. It seemed we don't have any more questions on the line. Would you like to give any concluding remarks before we end the call?

Sami Al Safran (36:09):

Yes. Thank you very much gentlemen, for participating. But I'm glad to share with you this result. We are looking for the second quarter to be another good quarter inshallah for us, and hope we can meet again to discuss with you some of the new opportunities and the challenges that we have as usual. Until then please stay safe. Thank you very much.

Alia (36:36):

Thank you, Mr. Sami, and thank you everyone else for attending. This concludes today's call.

Johan Van Vuuren (36:45):

Thank you everyone.

Ahmed El Fazary (36:46):

Thank you.