

Q1 2020 Conference Call Transcript

May 7, 2020 @ 1400 KSA

Michael:

Ladies and gentlemen, thank you for standing by. I would like to welcome you to MEPCO Q1 2020 Results call. At this time, all participant lines are in listen-only mode. The format of the call will be a presentation by the MEPCO management and IR team, followed by a question and answer session. After the call, you will have the opportunity to ask questions. If you have dialled in via the web, you may ask the questions using the online chat feature. So without further ado, I would like to pass the line to MEPCO. Bassem, the floor is yours.

Bassem:

Thank you. Thank you everyone for your continued interest in MEPCO. We will start today's call by stating the forward looking disclosure. 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 the 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 purposes. It does not take the responsibility to explain differences between future and actual results stated in the course of this presentation. Thank you. I will hand over the call now to Sami Al Safran, the CEO, to present an overview about the business performance in the first quarter of 2020.

Sami Al Safran:

Good morning, good afternoon, ladies and gentlemen. Tough times are nothing new to us. I'm pleased to convey to you that MEPCO is working efficiently, at full capacity, and in complete conformity with the local health and safety regulations. We are prioritizing the safety of our staff, customers, and partners. We acted swiftly early March and tightened our grip on health and safety measures, especially in the workers' housing factory level. Since the pandemic outbreak, MEPCO made no lay-offs and all our employees present in Saudi Arabia are fully paid, whether they are working in the company premises or at home.

Sami Al Safran:

As the world undergoes one of the major challenges in the modern history, the role of the packaging industries has never been more essential. MEPCO is playing a vital role in securing a steady supply of packaging materials to the local market. We shifted gears to prioritize local firms to ensure the undisputed supply of essential goods while fully meeting international customers' orders in the time. And of this unprecedented lockdown, we are witnessing [02:53 inaudible] demand driven by increased retail consumption. It's worth noting that this set of results reflect orders and contracted during the previous quarter.

Sami Al Safran:

When the prices have started to tick upward, having a good price increase in Q1 2020, we anticipated a better performance in Q2 2020. However, we have challenges at hand. We are facing a headwind in the raw material collection, through WASCO. This is not specific to our market, but seen across most of the

countries and it is offering [03:26 inaudible] the whole industry worldwide. Consequently fiber price increasing moderately, due to the limited supply and the safety measures has been taken amendments.

Sami Al Safran:

So far, MEPCO is protected from that situation from the inventory level we have, and from our backward integrated company, WASCO. On the sales front, what lies beyond June 2020 can be anyone's guess as everything is quite dynamic. Please allow me to stress that we are not expecting a decline in performance, but in times of heightened uncertainty, it's only prudent to adopt a rather conservative approach as [04:09 inaudible] provided appropriate guidance. Finally, I fall short to thank my management team MEPCO and WASCO for their efforts in managing and containing this situation. And most importantly, the factory workers who have put a tremendous effort to compensate for shift changes such tough times. Thank you, everyone. Stay safe.

Bassem:

I will now hand over the word to Dr. Mohamed Darweesh, the CFO, for a financial review on the results . Dr. Mohamed?

Mohamed Darweesh:

Good morning and good afternoon gentlemen. MEPCO management is keeping a close eye on evolving situation due to COVID-19 pandemic as it's very important to witness any adverse financial impact on operations. However, it's on our table by converting stress into opportunity through actively directing our resources to get maximum benefits out of it. However, being our team management depends robust assessment of possible impacts of prices of COVID-19 pandemic and the provided comprehensive management strategies to cope with this pandemic. So long there are factors, conditions, to corroborate our favourable assessment related to our financial and the financial assets. We have been exempted from curfew by government so no more interruption in business operation. MEPCO has recorded 18% and 15% higher production and sales respectively in the first quarter 2020 as compared to sales in the same time of last year, the first quarter of 2019.

Mohamed Darweesh:

MEPCO excellent sales price improved by about \$27, metric ton in month of March as compared to December 2019. WASCO may witness drop in waste material collection in short term. However, we have almost 50,000 tons fiber in store to make this in very shortage. Collection from trade receivables have improved in Quarter 1 2020 as compared to collection in same day of last year which reduced trade receivables by 15%. MEPCO trade receivables have reduced in the first quarter, as I said, by around 16% due to raw collection. Some financial investors who are interested in labor industry, anticipate pressure of raw material [inaudible 00:06:52] due to drop in public spending, but we have WASCO which have largest waste collection network in the kingdom, for continued access towards the raw material as a measure in getting of MEPCO raw materials at this minute is not available to our competitor.

Mohamed Darweesh:

We reduced the total debt by about 3.5% or about it and favourable net debt to equity ratio of 0.38 compared to 0.37 last year. We are compliant with all debt covenant as of the 31st March, 2020. Thank you and it's the time for Q&A.

Michael:

Thank you very much for the presentation. I would like to now open the call for questions. Please press star two on your keypad if you have a question or you may use the online feature, if you're logged in using the internet, using the chat. So, star two on the phone or the online feature. We'll give it a minute or so for the questions. Thank you.

Michael:

The first question comes from Mr. Chandra Pereira of Falcon Financial Services, about the price. How much is the increase in price as a percentage?

Mohamed Darweesh:

So the drop in the prices as compared to the first quarter of 2019, by about 16%. But we have increase compared to December, 2019 by about \$27. I speak about almost 5% or 4%.

Michael:

We have a couple of questions coming from Mr. Anoub from SICO. There are four questions here, so I will just maybe go one by one. First question, is Mr. Darweesh mentioned that production improved by 18%. What was the production and sales volume in Q1 and how do you expect utilization rent rates to trend this year? The first question. The second question is: How are you meeting the challenges of sourcing wastepaper during the period of lockdown? Could you please give us some colour on your wastepaper inventory levels and what contingency measures are available to ensure that production is not disrupted? Third question: How is MEPCO gearing up to meet the demand from e-commerce, which appears to be quite strong? Is there any special grade of paper that needs to be supplied for this? And the last question from Anoub is: Any update on your expansion plans?

Sami Al Safran:

Like what we had addressed in most of the meetings with the people, the company are working in the range average of 400,000 tons between sales and production. Mostly it's balanced. So if you divide it by quarter, we are between always 95 to 100,000 tons sales and production. At a certain quarter, we tackle up by 2-3%. At the soft demand we drop, but typically it's on around the 95 to 100,000 tons.

Sami Al Safran:

The second one regarding the waste supply, I think MEPCO strategically, since the inception, we identify that waste is a very critical factor in our business. And accordingly we have actually grown WASCO to control 50% of the wastepaper market in Saudi Arabia. Thankfully, WASCO showed really a great support during that crisis, where the lockdown is there. The global wastepaper availability dropped drastically that the international prices of wastepaper have almost doubled while in the local market we managed to maintain our costs at the similar average, with the maximum addition of 10%.

Sami Al Safran:

Definitely, the lockdown was very stressful because the resources of wastepaper was limited. However, it was still WASCO having their own 20 branches all over the kingdom, we were able to maintain WASCO operation in a close to 70% of the normal operation. In addition, too, like what we mentioned in our speech earlier, that we have, since the indication of that crisis, we stocked our inventory for raw material that gives us a smooth operation without really a major threat, unlike similar industries.

Sami Al Safran:

The second part regarding the e-commerce. It is true, there is a clear increase in the demand of container work driven by e-commerce. Actually, the share for the e-commerce container work transaction is almost doubled internationally. We do not have really a specific figures of Saudi Arabia because still e-commerce consumption impact in Saudi Arabia is not in the major mid-range.

Sami Al Safran:

Regarding the expansion growth, the expansion plans, I think MEPCO remains always agile in their assessment of their investment, selecting the options. I think you might have seen that early of last month, we have announced our acquisition for purchasing of land at [inaudible 00:13:24] with the size of almost 130,000. It's part of the expansion plan that we have announced. I think taking the land is an important step toward our expansion plan.

Michael:

Okay, thank you. The next question comes from Mr. Tasir Abbas from Derayah Financial. There are three questions here. First one is: What is the breakdown between price and volume impact on Q1 revenue compared to the same quarter of last year? The breakdown between price and volume.

Bassem:

I'm sorry, Mike. Could you please just repeat because I missed the voice?

Michael:

Sure. The first question is the breakdown between the price and volume and the impact on Q1 revenues compared to the same quarter of last year. The second part of the question is: How has been the price trends in the main products, locally, Europe and in the U.S.? If you could please provide some colour. This is just price trends on the main product in Europe and the U.S. The third part of the question is: How are you dealing with raw material collection? How many months raw material inventory do you have? Can you please quantify any savings that may arise because of your plans of various government incentives?

Sami Al Safran:

Okay, I'll leave the first part for you, Mohamed.

Mohamed Darweesh:

For [inaudible 00:14:58] as we said there is drop in [inaudible 00:15:00] in first quarter 2020 compared to the first quarter 2019. Of course, you could see this was combined with drop in the cost about 15%. If you are speaking about production volume, production volume increased by about 12% compared to the first quarter of 2019. Does that answer the question?

Sami Al Safran:

Okay, regarding the second one, about the price trend, internationally we are notifying a price cycles in almost two and a half years. I think by the end of 2019, we have seen that it's bottoming like what we mentioned. And now we have seen an increase that even MEPCO early, in February, we have announced a \$50 increase of our sales. Of course, this pandemic situation creates a lot of capacity to the situation. And of course, the economical world; however, let me speak about MEPCO. I think like what they mentioned in the beginning, we performed the Q1 better than Q4. We believe in Q2 we will maintain

the same positive performance. We will try to utilize our advantage, being a local supplier, to secure further our local demand.

Sami Al Safran:

I think the advantage of this pandemic situation is that it makes most of the consumers rely more on the local market than international, and that's what we have noticed, it translated into the case of MEPCO. This is to mention that some of the similar industries are struggling due temporary reasons where MEPCO is taking the measures to maintain a constant runnability of the business.

Sami Al Safran:

Regarding the last question about the raw material, in normal standards we in MEPCO are keeping an average of two and a half months inventory of raw material. This is equivalent to the orders on hand. We have them at the similar period, because since we are 24-hour operation, we always try to fill our order log-book for two and a half months. Similar to that, we maintain our own material. It happens that early of the crisis, we took a measure. We raised our inventory to three months, in addition to having WASCO as an owned company, they will keep always maintaining the required supply of raw material to avoid the drop of the inventory. Definitely it's challenging. It's a different head wind especially when the complete lockdown was there, but still we are in a better shape to maintain our operation. Michael?

Michael:

Thank you very much. Yes, there was a follow-up question to the previous one about the expansion. The question from Anoub is: Where is the land located and how far is it from your current setup?

Sami Al Safran:

Like what we have announced, the land is located at King Abdullah Economic City. It's almost one and a half hour from our existing facilities. The reason of choosing the land is the following. Number one is that the land has a natural gas accessibility, which really serve the purpose of the strategic growth of the company. That having the natural gas accessibility will keep the competitive edge of the company in terms of operation for the pure energy advantage. The second thing is the location for the land in the west coast. As you know that most of the time MEPCO is maintaining 40% export. Staying in the Red Sea will maintain that competitive advantage for us to maintain our export in the international market with the minimum cost. Finally, of course, the key is that it's one of the well-established facilities that will help a lot during the project construction and operation to reduce a lot of timeline for execution.

Michael:

Thank you very much. We just have a follow-up question, once again from Mr. Tasir Abbas from Derayah, about pricing. How is it that the revenue has declined year on year while the price and volume of product both have increased? Just a clarification here.

Mohamed Darweesh:

Yeah. There is a sales increase by about 20,000 tons compared to the same period last year. But the problem was, the price as I mentioned earlier, the price dropped by about 16% or 16.5%. That's why our revenue dropped as compared to the first part of 2019. But gross profit, if you look at the gross profit, it will be, of course, [inaudible 00:20:20] Net profitability, also the same.

Michael:

Okay, thank you. The next question is with regard to imported packaging products to Saudi and the outlook on that. Has the government taken any measures to lower imported packaging materials?

Sami Al Safran:

I think last year, it was announced by the government about the carton industry as one of the industry that's subject for damages due to the anti-dumping activities happening. This is besides the anti-dumping case which went by the GCC and there is announced measures to be taken. Some of them is already in a force. One of them is that requesting an import licenses for the paper ... sorry, the testing certification for the paper to ensure compliance of the quality to the standards that we do, which we believe this will positively help to further drive the market to be more mature and enhance the opportunity for MEPCO. The second one, it was recommended to increase the customs duties from the current situation of 5% to the maximum. That this resolution has not come in a full force yet, so we believe with those measures, it should drive to the positive direction of the company.

Michael:

Thank you very much. The next question comes from Mr. Al Anoud Al Rasheed from Jadwa Investment. What would the \$50 increase in price translate to in percentage terms? \$50 increase in price, how would that translate into percentage terms? How different are your margins from local and export markets?

Bassem:

Okay, I'll take this one. With regards to the percentage, I know it's a logical question to ask what it represents, but in the paper industry, if you see the announcement of paper companies, it always comes out in absolute terms not in percentage terms because we have many products. Eight products. So we apply one increase across the board and we roll out that price, that increase. It acts as a starting point of negotiation. It is not a ticket price that is passed to all clients alike. It's a starting point for negotiation rather than a fixed increase. The other part of the question is about the margin. Well, it depends. Of course the local orders will have a cost advantage in transportation compared to exports by design, but we make sure to balance two things, to cater for our clients abroad and maintain our market share in the markets we export to, as well as maintain the profitability of each and every deal we make.

Michael:

Okay, thank you. The next question is: Any update on the governments setting up new companies in waste collection, especially in the current macro environment?

Bassem:

Sorry, Mike, can you repeat that?

Michael:

Yes. Any update on the government setting up new companies in waste collection, especially in the current macro environment?

Sami Al Safran:

The company has been established and they started their activities. I think they are doing some construction in the city of Riyadh. However, I think we are very much eager that they grow because the establishment of the company means that the regulation of the waste market in Saudi Arabia, which

should positively serve the raw material cost of MEPCO side from one side, and enhance the opportunity of WASCO from the other side. Because once the industry will happen, WASCO is one of the most readily available company to be leveraged in the regulations of the waste management here. I don't see a plan for freezing their activities because I think they are in the contracting space for some projects and it doesn't look to me that there is any notification yet for delaying the project.

Michael:

Okay, thank you very much. There's a follow-up question from Chandra Pereira from Falcon. MEPCO was also expecting the government would take measures that will increase the availability of raw materials for WASCO. Can you please give an update on that?

Sami Al Safran:

Yeah, that actually follows the previous question, which I mentioned. Like what we mentioned earlier, the government has announced their national waste management strategy. By 2035, Kingdom of Saudi Arabia is supposed to recycle 80% of the generated waste and a 20% to be converted to energy. Accordingly, through **BIS [26:27 inaudible]**, they have established the waste recycling company called SIRC, and they stopped their activities in contracting to build the first of their business unit in Riyadh city. By doing so, we anticipate that the wastepaper markets of Saudi Arabia supposed to normalise similar to the rest of the world. To give an example, until now, in our practices, the cost of the raw materials in MEPCO besides what happened in the Corona or the pandemic case of COVID-19, before that used to be always the cost of raw material in Saudi Arabia is almost double than the international market. We believe by the growth of the recycling industries in Saudi Arabia, it should drive separately to drop the cost of the recycles to be similar to the rest of the world.

Michael:

Thank you very much. We have a next question. This is a three-part question again. Due to limited supply of raw materials, fiber in particular globally, do you expect the raw material prices to continue increasing going forward, putting pressure on the margins? Second question: Going forward, where do you see paper prices in Q2? Higher or lower compared to Q1 2020 and Q2 2019? And the third question is: Due to the worldwide lockdown, are you having a difficult time exporting? Does it explain the increase in percentage of local sales compared to exports?

Sami Al Safran:

The first one regarding raw material, it's actually true. Due to the situation, the prices of raw material has been escalated very high. It's rather even \$100 higher than the normal. However, we do not anticipate to see this as a long term effect. With the release of the situation, we anticipate that the raw material prices should normalize, especially that China still are not releasing their regulation regarding the restrictions of the wastepaper. Regarding the prices of Q2, I'm sure, I mean, if you read any international news, people are telling you they are expecting a negative results. Whereas, I think, in MEPCO, I mean, until now we are doing all what does it need to show a better results than Q1.

Sami Al Safran:

Last thing, due to the global disturbance of curfew, see like what I mentioned early of my discussion, packaging industries, majority of it related to the non-durable goods, and one of the ... we have noticed that due to the lockdown, the consumption of non-durable goods between food, detergents, and other went very high. That really maintained the healthy demand of the packaging industry. The hygiene

concern was also one of the drivers for the people to focus on packaging. We have seen that food delivery went to double and the triple packaging than they are normal packaging. So I think packaging industry is one of the ones that is benefiting from this kind of situation.

Michael:

Thank you very much. We have no further questions at this point so I'll just prompt once again. Star two, if you're on the telephone for questions or using the chat feature, if you are logged in to the telephone call via the web. Star two on the phone or chat by the web. We'll just give it a minute or so for any final questions.

Michael:

We have a question from Mr. Amar Al Alali from HSBC, Saudi Arabia. I'm opening the line. Please, go ahead, sir.

Amar Al Alali:

I have one question regarding the prices. You've talked about the prices, but if we're going to compare the average price for the first quarter compared to, let's say, 2019, how is the average price in the first quarter compared to 2019? Where do you see the prices beyond the second quarter of 2020, for the remaining of the emergency, the prices on average compared to 2019?

Sami Al Safran:

Like what we mentioned earlier and, I think, in our business model, in MEPCO we usually have an order logbook with an average of two and a half months. Usually, we negotiate and we consult, so I mentioned in last discussion, in last call, that we believe the prices **bottomed**, which is the end of 2019. So if you compare the early Q1 with Q4 2019, you will find Q4 in their lower position. If you compare Q1 2020 with Q1 2019, you will see further prices dropping. However, comparatively between Q4 and the Q1, you would find an increase which reflected in the financial results. Still, we have not fully rationalized the price increase, which means Q2 should be in a further or a better position than Q1.

Amar Al Alali:

Thank you very much, Engineer Al Sami.

Michael:

Thank you very much. We are showing no further questions. I will therefore pass the line back to MEPCO team to conclude today's call. Thank you.

Sami Al Safran:

Thank you very much, gentlemen, for participating in the discussion. What happened in the last two or three months with us was a very interesting period. I call it very challenging. We haven't been through those situations in our life experience, and I was really proud that our team has managed this situation in a great manner. We maintain our operation properly for the last period. We've got to really adapt ourselves to the different changes that happened, and thankfully we achieved those results under this stressful conditions. We are advised that our way forward will be positive. Thank you for trusting MEPCO.

Michael:

Thank you very much. This concludes today's call. We'll be closing the lines. Thank you.