

MEPCO

CONFERENCE CALL TO DISCUSS MEPCO FINANCIAL AND OPERATIONAL RESULTS FOR THE FIRST HALF OF 2020.

Company: MEPCO

Presenter: Eng. Sami Al Safran, CEO

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Participants:

Eng. Sami Al Safran, CEO

Dr. Mohamed Darweesh, CFO

Bassem El Shawy, IRO

Operator

Ladies and gentlemen, thank you for standing by. I would like to welcome you to MEPCO first half 2020 results call. At this time all participant lines are in listen-only mode. The format of today's recorded call will be a presentation by the MEPCO management in IR team, followed by a question-and-answer session. After the call, you will have the opportunity to ask questions. If you are dialed in via the web you may also ask the question using the voice or text feature. Without further ado, I would now like to pass the line to MEPCO. Bassem, the floor is yours.

Bassem El Shawy, IRO

Thank you, Mike. And thank you everyone for joining us today. We will start this call by a forward-looking disclosure statement as usual. This presentation may contain forward-looking statements. While management has made every effort to present a fair view of MEPCO operational and financial performance, it is important to acknowledge that the expectations about future results, the common line of prevailing operational, financial and market conditions may change in the future. Management does not give forward-looking statements for financial investment decision purposes. It does not take responsibility to explain differences between future and actual results stated in the course of this presentation. Thank you. And I will hand over the presentation now to Engineer Sami Al Safran to present an overview about the business performance in the first half of 2020.

Eng. Sami Al Safran, CEO

Good afternoon and good morning, ladies and gentlemen. We are proud of the excellent set of results, which reflects efforts done at these challenging times. As the prices started recovery during the first half of 2020, we have positioned ourselves to strike a sensitive balance between maximizing our return and ensuring full customer satisfaction. Demand on containerboard was notably high during that period, driven by increased customers' demands to secure current consumption and stocking for future needs. In addition, heavy reliance on online shopping due to lockdown.

I'm proud to confirm that we were able to meet this highlighted demand with a record level of production. MEPCO achieved a record high production levels during the peak of pandemic situations. Our production level exceeds 220,000 tons in the first half of 2020, with an annual increase of 14% while operating with reduced manpower. Out of our profound responsibilities towards supporting our homeland market, we focused on the local market demand during the first half of 2020, which resulted in 49% increase in local sales compared to the same period of 2019. This translated into sales mix that with a bigger share of conventional containerboard products to meet market demand.

I extended my sincere gratitude to our stakeholders, particularly my team, for these outstanding achievements. On the raw materials front, local and international prices increased during the lockdown period due to the curfew situation, which made collecting and transporting the required materials challenging. However, we were able to secure a steady supply of raw materials for the duration of this period, enabling us to run our operations uninterrupted showing the pivotal role of WASCO at this tough time.

Our outlook for 2020 is on the cautious side, due to the future uncertainty. Concurrently, we foresee demand on the product to remain steady. As the economy is recovering gradually, however, pressure on the crisis may yet exist. On the raw material side, as more countries adopting strict environmental regulations, shadowing China's regulations issued in 2019, we expect prices to trend down in the medium term. This forecast remains subject of course to both market dynamics and issuance of international and local regulations. We have made noteworthy economic achievements which lay concrete foundations for our current and future operations. It's without doubt that the future will reflect positively on our shareholders. Now I would like to pass the discussion to Doctor Darweesh to address his comments also.

Dr. Mohamed Darweesh, CFO

Good morning and good afternoon, ladies and gentlemen. It's a pleasure to see all metrics positive. We've made several accomplishments, including, besides the excellent performance, we successfully reduced the short-term debt position by 31% to reach 118.5 million Saudi riyals down from 171.7 million, while the medium-term loan increased by 1.9%. MEPCO's total debt position improved by 6.7% compared to the same period of 2019. This evidences the company's ability to generate a strong and steady cash flow.

Collectively the debt service for H1 2020 standing at 10.3 million Saudi riyals, dropped by about 20% compared to the same period last year. This significant debt reduction brought down our debt to equity to 0.82 times, which is an excellent metric in the paper industry. This low debt level unlocks MEPCO's ability to gear up and fuel the future growth. Total inventories at the first half of 2020 is 13% less than 2019. Major changes are due to significant decrease in raw material. On the flip side, general and administrative expenses decreased by 20% in the first half compared to the same period 2019. Major reason being decrease in salaries,. Selling and distribution expenses also decreased by 1% in the first half 2020 compared to 2019. Major reason being the decrease in terms of operation and shipping, sales commission, salaries, wages and (?)

Thank you. I will pass the mic to Mr. Bassem.

Bassem El Shawy, IRO

Thank you Doctor Darweesh. And now over to you, operator, to start the Q&A session.

Operator

Thank you very much. Now, I would like to welcome you to the Q&A session. If you have questions, please press star-two on the telephone pad. If you're dialed in via the web, you may also use a text function. Thank you very much. Our first question comes from Mr. Anas Al Safadi from NCB Capital. Please, go ahead. Your line is open.

Anas Al Safadi, NCB Capital

Thank you for the call. I'd like to get some insights on what is the outlook on paper prices for the remainder of the year, of course, the paper prices and the raw material? That's my first question. My second question, any updates on the land that was acquired a couple of quarters ago? And if there are any updates on this topic, it would be much appreciated.

Eng. Sami Al Safran, CEO

Thank you for that. Let me start with the second part of your question, about the land. We acquired land (?). According to the announcement, the project that is supposed to be initiated on this land has not been communicated at this point. Of course, this is something that we cannot communicate right now. And we will be making a proper announcement when things have been put in the right perspective. Regarding the prices, we have seen an increase in prices, because in the beginning of this year we started from a low base in the fourth quarter of 2019, after the serious drop that happened throughout the year. And this improvement continues along the first quarter. Then prices started to stabilize. What we are forecasting for the remaining of this year, it is a little bit difficult to say accurately 100%. We expect prices to remain solid for the time being. If there will be a slight ease in prices, it should not be significant. This is how we see things for now.

Anas Al Safadi, NCB Capital

And what about the pulp prices? I think pulp prices have been gaining momentum in the past couple of weeks.

Eng. Sami Al Safran, CEO

Yes, pulp prices of course faced some pressure in the pandemic times because of the difficulty in collection. Let me verify with you, by pulp you mean the fiber, or you mean the OCC?

Anas Al Safadi, NCB Capital

The OCC.

Eng. Sami Al Safran, CEO

So, OCC. As you know, OCCC composes a bulk of our inputs of production. Because of the difficulties in collection during the pandemic situation, prices increased slightly. And now, the prices are stable. Also, we expect the prices on the medium term to decline. Because of China previously announced that they will stop importing all materials for recycled paper manufacturing starting 2021. Which is something very interesting for us to see materializing at the beginning of the next year.

Anas Al Safadi, NCB Capital

Perfect. And I have a question on volumes. How were volumes in Q2? And how are you seeing the volumes now? And my final question is on WASCO. How are you seeing WASCO now? There was a new recycling company that was launched earlier this year. Can you give us color on how will WASCO benefit or not from the launch of the government-based company?

Eng. Sami Al Safran, CEO

This is me, Sami. Regarding the volume, we usually maintain an average of 100,000 a quarter. However, what has been done, that the extensive demand for the second quarter due to the lockdown situation, where import was interrupted, and, accordingly we (?) pressurized our performance, and we have exceeded the target. So, the second quarter is higher than the first quarter by almost 15%. We anticipate that this will continue to maintain our high productivity. I had asked this question before about the production volume of the company, and we were talking about 400 average on annual basis. Now we are talking about 430,000 average. We've done a couple of minor improvements, that led to increasing the capacity of our machines.

Regarding the question about WASCO. Actually, the issue is not related to the company specific, it's related to the vision of Saudi Arabia. Saudi Arabia (?) in the recent future was practicing the waste management in a conventional way, where we are collecting waste and sending it to the landfill directly without any processing. And that was the reason why WASCO has been established, is to create value of recyclables. Which positioned WASCO to be the largest waste management company in the Middle

East region with a capacity of 0.5 million tons of recyclables. Now, two years ago, Saudi Arabia have announced the ambitious plan of waste management, where targeting by 2035 almost 100% of generated waste will be diverted from landfills to go for either recycling/reused or waste energy. And accordingly, PIF has established the financial arm which is served as an investment in the waste management industries. Now, we see this one as a great opportunity for WASCO from both sides. Number one, WASCO has a good position in waste management, where they can contribute with a lot of their capabilities with different commission activities of Saudi Arabia. And number two, which is a very important issue mentioned before, the cost of wastepaper in Saudi Arabia is still higher than the rest of the world. We have almost 100% higher than the Europeans in terms of raw material. We strongly believe by regulating the industry and creating more availability of recyclables, it would help MEPCO positively to reduce the cost of the raw material.

Anas Al Safadi, NCB Capital

Thank you for the clarification. Thank you, Engineer Sami, Dr. Mohamed and Mr. Bassem. Thank you very much.

Operator

Thank you very much. Our next question comes from Mr. Isham Referera from Falcon Securities. Please, go ahead, sir. Your line is open.

Isham Referera, Falcon Securities

Yeah, thank you very much. How do you see the competition in the local market from international players after the government imposed the anti-dumping duties in 2019?

Eng. Sami Al Safran, CEO

Well, I think it's not a secret that not only Saudi applied governmental duties. It was declared also that paper industry is one of the industries that was affecting from dumping activities, on Saudi Arabia specifically. And accordingly, the Ministry of Industry is addressing a set of initiatives to regulate the market and defend the industries. No doubt, we have not really materialized it well until now, because still, the process of implementation and rationalizing such kind of (?) measures takes a significant amount of time. However, there is a great communication between us and the officials at the government side, to propose a methodology of managing and controlling the (?) non fair-trade competition which is coming from outside. I think you might have seen lately; the government has announced a revision of the customer duties of different products. 30% of our production duties has been increased from 5% to 8%, which improves the opportunity of our business. However, we are in process with to them to take further measure for a better control and monitoring of an import to create a good competitive environment for our business at the local market. That's from the International side.

From the local side, the market remains stable as is. Our presence as a market leader in the Middle East is there. There are some other players in the market. However, I think we are still positioned to be

a recognizable player in terms of infrastructure capability, reach, export capability from different angles, in addition to be a well-governed public listed company.

Isham Referera, Falcon Securities

Just to confirm it's already applied in Saudi Arabia, the anti-dumping duties. And after that application, how the price differences will be between you and the products from outside?

Eng. Sami Al Safran, CEO

Actually, the duty has been applied across GCC level. It was imposed on the rate of 25% to 30% from Spain, and 30% from Poland. Which, we have seen a significant drop from those two countries. However, again, in general, the total supply of products to Saudi Arabia did not drop significantly. Still there is an import. Because what has happened is a shift of a market from Spain to other countries, which we are now assessing. And potentially we are looking closely to take different measures to streamline the market. However, answering the question, it's across GCC level, not only Saudi Arabia.

Isham Referera, Falcon Securities

Yes. You mentioned that your sales volume mainly increased in Saudi Arabia and the local market. How do you see the volume in the local market going forward?

Eng. Sami Al Safran, CEO

We have addressed earlier that the local market and Saudi Arabia consumption ranges between 800,000 to 860,000, which we have seen. The good news is that most of that demand focusing in FMCG mainly. Which, during the economic stress, which happened a couple of months ago, we have not seen a major drop in the FMCG demand. Which, as a result, does not affect our market. So, however, if you ask me personally, which is non-scientific, but based on our discussion and our market assessments, we believe there is a drop of total consumption by 10%. However, at the same side, I think the pandemic situation showed, how important the local manufacturing unit to be there to (?) tackle the urgent situations like the pandemic, where there was a turbulence of the imports of packaging materials. And accordingly, MEPCO jumped in. And we have focused together on the market demand, which successfully (?), we have increased our supply to the market by 49%, compared to the similar periods last time.

Isham Referera, Falcon Securities

Yes, currently, I mean, given that the FMCG demand might be less after the COVID. So, when it comes to the demand, probably you might be trying to increase your exports or moving into some of the other industries within Saudi Arabia. So currently, I mean, what is your plan to ensure that the volumes might not be impacted going forward, because the FMCG demand might be less?

Eng. Sami Al Safran, CEO

Well, I think it's the other way around. After, I mean, we mentioned in our first release after the lockdown and normalizing the business process we have seen some recovery in a different area, including the containerboard sector, whether from the local market or from the international. Of course, the advantage of MEPCO is that we are in a well-positioned situation logistically, that we can modulate between export and local, based on a supply and demand need. So, like I mentioned earlier, we do not anticipate a softness in the demand for the coming quarter. Rather we are maintaining our operation in a full load and full supplies.

However, we would like to assist but until now there is no any major indications for soft demand in the local market. I am talking about MEPCO side, not from the total side of course.

Isham Referera, Falcon Securities

Okay. My final question is with regard to prices and profit margins. Is there a difference between local sales and export sales? Thank you so much.

Eng. Sami Al Safran, CEO

It's a bit tricky situation. Because I think if you've seen the product portfolio of MEPCO, although we are a commodity producer, but we have increased our product portfolio into 12 different products. And accordingly, the margin is subjected to the selected products, and then the selected market. Of course, regarding the market, MEPCO is one of the agile companies, that we are modulating our sales to the market that has a higher revenue always. Whether it is a local / international; when you go to international, whether it's a nearby region or a remote region. It doesn't matter as long as it has a better revenue for us, we will focus. And that's why if you see the statistics of our sales, you might really get it from the Saudi exports for the previous years. You will find always that we are moving from one country to another that has the better opportunity return for us

Isham Referera, Falcon Securities

Okay, thank you so much.

Bassem El Shawy, IRO

We have a question from Zeeshan. Zeeshan is asking: can you provide more color on the demand from end customer in terms of prices? And what is the management's view on strategy going into the second half of 2020? And finally, what are the key export markets and how in terms of profitability the export versus the domestic market? I think we talked on the first part, and the last part of your question.

Eng. Sami Al Safran, CEO

Regarding the export market, although it's been answered. However, traditionally, the priority for us is the nearby markets around the country, before we start to move remotely. A priority number one is the

nearby markets. We are talking about GCC, East Africa or Levant, including Yemen. And the second priority market for us is the Asian market.

Bassem El Shawy, IRO

The next question is from Ambereen. Ambereen is asking about the price we pay for energy, and if there are any thoughts about subsidy removal.

Eng. Sami Al Safran, CEO

MEPCO is paying the same price of energy like in the similar industry, which is announced prices by (?) Aramco. We do not have a special privilege for that. Regarding the subsidy removal, I would not really call it subsidy, because now the price is under revision. However, I think if you are monitoring what's happening after the creation of the ministry industries, one of the directions of our custodian authority (?) is to review the energy pricing up to 2030. So, until now, there is no indication of talks from the government about the price revision. However, it's been addressed earlier, we ran our stress analysis and we have indicated the contribution of energy to our business. And I remember, we have mentioned in our talks, if the energy prices increase by 100%, the impact will be limited to a 3% of our cost of sales.

Bassem El Shawy, IRO

The next question is from Anoop. Anoop, regarding your question, the production of the first half of 2020, we cannot have the split between quarters right now. And this is of course the finished product volume, not including the wastepaper.

Regarding the question about a big increase in demand, yes, customers were stocking more. And of course, there's an e-commerce boom. Nothing fundamentally changed in the industry, locally. The pandemic of course affected the industry globally, especially with regards to China factories shutting down during the pandemic situation, which dried up the supply in the market. And having China going back online and pumping the quantity stock in the market affected the global supply of course, and the prices as well.

The next question, we have is by Samer Darwiche. Samer is asking about the price increases.

At the beginning of the year we announced the price increase of \$50 per ton. And in paper industry, it is not quoted as a percentage of the base price, it is quoted as an absolute figure. Because this constitutes the starting negotiation with clients, but not all the \$50 are applied for each and every client. It depends on the client relationship and the volume they acquire from MEPCO.

Eng. Sami Al Safran, CEO

The cycle, of course, we've seen the cycle bottoming in 2019. And as we started diverse of the cycle, the prices were trending up at the beginning of this year. The pandemic situation of course came in to

change a lot. And now we're on a stable platform when it comes to prices. Forecasting is quite difficult, Samer in these conditions.

Bassem El Shawy, IRO

We have a follow-up question from Anas about the batch of new customs duties impact and how we this impact.

I will start, the second part of this was regarding the weak Haj season, we've been witnessing strong demand so far. And we didn't see a lot of impact during the second quarter as shown in the results. And third quarter should look good as well, nothing explosive. But we were hoping to maintain the same trend. As for the first question, I think Dr. Darweesh will answer that.

Dr. Mohamed Darweesh, CFO

(?) our custom duties are immaterial. (?) only in the cash flow for 4 or 8 months, last month. As I mentioned earlier, there is no any impact or immaterial impact for that. It will impact the cash flow only for 2-3 months. And any (?) from the government. For custom duties, the impact will be also immaterial in terms of cost of goods sold.

Operator

Okay, thank you very much. We have a question from Mr. Ashish Prajapati from United. Your line is open, sir.

Ashish Prajapati, United

Basically, we wanted, if you can update on WASCO, and how the wastepaper collection continues in this pandemic period, any stress on that side. Thank you.

Eng. Sami Al Safran, CEO

I think the pandemic period really proved the importance of the backward integration, to guarantee a sustainability of the business by (?) will materialize during the pandemic. The pandemic period was actually pressurizing a severe lockdown where (?) transactions of goods including wastepaper was very challenging. However, at WASCO we are having (?) of 350 trucks distributed across the Kingdom with 21 branches. And they have managed to maintain the supply of our demand in the local market. Of course, the crisis period, when there was an early indication of the crisis period, MEPCO has taken different measures to secure a sustainable operation for that. We entered the season with a quite comfortable inventory level. And that inventory level has been utilized well during the crisis period. WASCO maintained their operation during the same period. And accordingly, by God's grace, we have not been interrupted in our business due to the lack of raw materials.

Ashish Prajapati, United

Can I have a follow-up question on the same. Sorry.

Eng. Sami Al Safran, CEO

Please, go ahead.

Ashish Prajapati, United

If I remember correctly, in the last conference call, you had also discussed about setting up a government agency in wastepaper collection. So, any update on that?

Eng. Sami Al Safran, CEO

Yes, that question was asked during the conference call, about the PIF has established an investment arm for the waste management. And they are the one now who's actually signing the MOU agreement to build Emaar (?) facilities at Riyadh City. We are in close contacts with them. Because for us being the largest player of the waste management industries, we are here to help with a lot of information and collaboration. Also, we are one of the good potential uptaker for their product. And I think that the company is progressing well, because they signed MOU to build Emaar (?) facilities for Riyadh. Which we believe within two years should be completed, and operational, which potentially we could see a more availability of raw materials for the local market, that can enhance the growth of the business, in addition to normalize the prices of the raw material to be in line with international.

Ashish Prajapati, United

Thank you.

Operator

Thank you very much. Just a reminder, start-two for questions. We have one more question here from Abdulrahman from Derayah Financial. Please, go ahead, sir.

Abdulrahman Aimukairin, Derayah Financial

Okay I just need the average prices for the Q2 and the first half of 2020 for the product and also for the raw materials.

Eng. Sami Al Safran, CEO

We usually do not share those numbers, as we are working in a competitive environment. We try to avoid participating with (?) figures of our coworkers.

Abdulrahman Aimukairin, Derayah Financial

Okay, what is about the international prices, at least?

Eng. Sami Al Safran, CEO

The both, the raw material is available under the indices called OCC, Old Corrugated Cartons, OCC 11. And usually that's the benchmark which we are using for the trending prices up and down. And for the finished product, usually the containerboard sector is the sector we are (?). Which has also its own indices internationally. I think if you monitor those indices, you can see how it is trending up and down (?) being part of the global (?) accordingly.

Abdulrahman Aimukairin, Derayah Financial

Can you please repeat, the OCC and?

Eng. Sami Al Safran, CEO

Raw material is under the term of OCC 11, and finished product is under the term of containerboard. Now containerboard has different products. I would recommend if you can look for Testliner 2, that will be a good indicator of the price reactions of our sales.

Abdulrahman Aimukairin, Derayah Financial

Thank you

Operator

Thank you very much. I'm seeing no further questions. I'll pass over the line back to the MEPCO team to conclude the call. Okay, ladies, gentlemen, I just heard from the MEPCO management team, that they will be indeed closing the call, now that we have no further questions on the line. So, thank you very much for joining this call. If there are any questions, please contact Bassem and directly. And apologies for the issue towards the end. Thank you.