

MEPCO

CONFERENCE CALL

Company: MEPCO

Presenter: Bassem El Shawy, Head of Strategy and Business Development

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Participants:

- Sami Al Safran, Chief Executive Officer
 - Mohamed Darweesh, Group Chief Financial Officer
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Bassem El Shawy, Head of Strategy and Business Development

Hello, good afternoon, everyone. Thank you for attending today's call. We're very excited to be with you on the call today to give you a completely new dimension of the business plan we're having.

Today we introduce the new initiative of MEPCO as part of this strategic plan that we have been developing since March 2020. This plan actually has been developed with one of the top tier consultancy firms in the world. It took us quite an extensive amount of effort to arrive at the final plan and it is extremely ambitious, it aims to multiply the size of the business within the next five to seven years.

I will give you a very high-level overview of how this plan is working and what are the main pillars of our growth strategy. This plan is mainly focused on growth and it has two main pillars. The first one is operational efficiency, and the second one is the growth initiatives.

The operational efficiency initiatives focused on the operational transformation of both MEPCO and WASCO, and WASCO as you know has been kick started a year ago with collaboration with Roland Berger. There is still more room to improve and refine WASCO operation and further expand its business model.

The MEPCO operational transformation focuses on multiple areas with regards to the costs, revenues, and further tweaking to the operational model of MEPCO. What we are tapping on here today is the first of the growth initiatives, which is the tissue jumbo roll production. This horizontal integration initiative is targeting expanding MEPCO into other venues of paper products, which is tissue products (a consumer product).

So now MEPCO is stepping out of purely container manufacturer into tissue business and tissue also has a lot of sub-categories with it. Tissue is using a different kind of raw material, which is virgin pulp, also imported from different parts of the world, mainly from Saudi Arabia and Southeast Asia.

I will take you through more details about the tissue. But first, let me answer a common question that we've been receiving quite lately: Where is the fourth production line of MEPCO (PM4)?

The PM4 project hasn't been canceled, but has been de-prioritized and the board has taken the decision to de-prioritize PM4. And now with announcements, we have been working for the past 18 months with the new tissue project that replaced and took over priority from the PM4. We're putting this forward now and the fourth production line of MEPCO has been taking a lower priority due to many reasons.

We have also other initiatives with regard to growth, some of which cannot be disclosed at the moment. But we are telling you that our growth from it has been realized at this period, we are realizing improving what we have been communicating to you in the past 18 months, and we are here now giving you this plan. I will not dwell much further into this. I will move straight to the tissue. Let me give you an overview about what we're talking about here.

The tissue project is 340-million-riyal project. It has a different dimension of course than containerboard. I was talk about the market size and the whole market attractiveness principle. Why are we going into tissue? Tissue in Saudi Arabia has an estimated demand of about 250k tons, this information relates to 2018. In the last four years, this number has been growing rapidly, and by about 2.7%.

Tissue of course as we all know is a fundamental consumer product. We saw the importance of tissue being highlighted during the COVID situation, and we expect more of that to be happening going forward. So, three years statistics about the regular growth of tissue has shifted significantly by the impact of COVID that has changed so many things in our lives. Collectively Saudi Arabia uses about 2 million ton of paper products in a year that could be about 250k tons that relate to tissue products specifically.

Here we see the growth. Tissue is a growing commodity; yes, it relates to GDP, yes it relates to consumer spending. It relates also to consumer behavior, which is something that changes along the likes of nations. And we're seeing Saudi Arabia now has been changing seismically during the past three years, everything is changing positively in Saudi Arabia, and the consumer spending also has been changing. Some changes are, might be perceived as impactful negatively on the consumer spending. But there are other many

aspects that change the consumer spending positively towards higher consumption of things like tissue, like for example Cost. So, we're seeing really healthy demand, and we're expecting this demand to increase. We have many benefits of being in the tissue business as compared to the container board, and we'll dwell into that in the next slide.

Here we see the potential, this slide actually is quite interesting, because it shows that the consumption per capita of tissue in Saudi Arabia is estimated to be around 7kg per capita. So, this is when Saudi Arabia falls in comparison with other countries. If we see a country like Kuwait, for example, because they have higher per capita income due to a smaller size of population, we'll see there's about 50% upside. If we compare to more mature regions of the world, like Western Europe and the United States or North America we see a huge jump of about 250%.

So, as the economy and the population mature, the consumption of tissue increases dramatically. What we want to say out of this slide is that we have a long way to go before we reach a steady number of consumption when it comes to tissue products per capita. We'll send quite young and we have a very promising future to come. Here's, we're comparing these tissue products with the container board, which is going to be a common question in anybody's mind: how it compares to your current business?

Tissue in general and has less volatility than containerboard. You've always seen the results of MEPCO, it will seem that we sometimes have results that are swinging up or down. So, tissue, although not saying that everything is static or fixed, tissue should also fluctuate but it fluctuates as a much lower volatility rate. So, as relates to GDP, you will see container board and tissue and the swings are much smaller when it comes to tissue in general. The virgin pulp prices can swing but at a much smaller rate, then be the RTC price.

This should give MEPCO much more stability in terms of revenue and a sense of profitability. It depends also on the degree of contribution of the tissue, which is something now we are not willing to give precise numbers about. You know that we will be producing 60,000 tons per annum. So, you can roughly calculate the figures. But the important factor that we want to say is that we are adding things that should help stabilize the return or shareholder value; what you should be getting from MEPCO in the future within the next five to seven years not only will be maximized, but will also be seen live and stabilized, which is something that is of major concern to most investors, the stability and steadiness of earnings and what the company gives them back. This has been in our cross hairs for quite a long number of years, and it took tremendous study from us to arrive at the most suitable decision of engaging the tissue business.

Okay, why Saudi Arabia? Because we could just actually do this in any part of the world, Saudi Arabia is as we said, it's a 250k ton market per annum. When we see this kind of demand, and where is our niche, where is our low hanging fruit, we say here that we are at a cost advantage in Saudi Arabia. When you look at the initial map of who produces tissue at what rates, you will find Turkey, Egypt and UAE,

surrounding Saudi Arabia, and they do export all the Saudi Arabia, but look at the cost breakdown. The variable cost more or less is the route in the same range due to the high contribution of virgin pulp into the variable cost. It takes the lion's share of this segment, and the good news is that this cost is quite equal pretty much for everyone, because none of these companies produce virgin pulp. This is all imported from Scandinavia from Europe or Southeast Asia. So, we all import at pretty much the same rate. What the game is going to be about is the fixed cost; managing your costs. We have a good advantage in fuel, and we have other advantages in Saudi Arabia's might be taxation, might include labor compared to other parts of the world. The bigger advantage in Saudi Arabia as you're serving the local market primarily is the logistical costs, because our customers are going to be converting customers, who will take jumbo rolls and converting into end products and they require steady continuous supply of raw material, and this is where our advantage comes. We'll also take a look at this further in the next slide. So, what we're offering here is a profit margins that could relate between 30 and 35%. Why 30 is not a for example, is something I would benchmark against as a possible country that will export? Because they mainly tapping into the European market. So, when it comes to both Egypt and UAE, we are at par if not at an advantage as to the logistical costs, we have a clear advantage over that.

The market is segmented into two main categories integrated and non-integrated players. The integrated part is dominated by about five players only, locally, the market usually supplies about 80,000 tons. So, we have 170,000 tons imported and this is actually where the difference. Important materials of jumbo tissue rolls, we incur an additional cost as to the logistical costs and what have you, and we have a clear advantage in that effect.

So, there is significant margin difference between the cost I will be producing at and the cost that of that important material coming from abroad. So, the bigger part is this market the like of import. And this was the main driver why we saw a significant opportunity in selling in the local market. Converting companies locally in Saudi Arabia will be willing to pay a premium and because of these people. As I mentioned, the conversion of tissue requires steady and continuous on time back to back delivery. So, we are telling them a good deal of happening when it comes to transporting the raw material rate to the doorstep. Normally find the course and then they carry lower inventory, cheaper transportation and other packing also that will help them make this easy decision buying from a local source than importing from abroad.

And finally, to give you more room to ask questions, and I'm sure you have a lot of questions. This is where MEPCO is playing now, you see this category. We are indirectly supplying through ecommerce through packaging, we are supplying food packaging, other consumer products and now we are into the tissue grade. So, we all the segments that MEPCO is working on now the next moment of it is extremely promising. We are not into other types of paper grades that have a negative outlook like graphic paper, for example, this, these segments of diminishing or they have a negative outlook forward after COVID. All our segments are extremely positive. And we really look forward to jumpstarting in this project and

giving you another dimension of what MEPCO can do. Without further ado, I will open the Q&A session please wait I have here, Eng. Sami Al Safran, CEO and Dr. Mohammed Darweesh, CFO.

Operator

Thank you very much for the presentation, we will now move to the question and answer session of the call. You may ask a question online by a text or also by a voice just press a button, or we'll come back to shortly we'll get 30 seconds for questions.

So, we think the first question is from Anoop Fernandez from SICO, please go ahead, your line is open.

Anup Fernandes, SICO

Hi thanks so much for the presentation. Very informative, very useful. I missed the earlier part. Could you please give us some color on whether on when this project will be completed? And where is the machinery coming from? Have you already placed the orders for the machinery? Is it going to be a new machinery that you're going ahead with? Or is it some secondhand machinery like you did with the container board? Secondly, you know, related to the costs, the slide on the cost is quite intrigued. Why are the costs in Egypt, so low compared to Saudi? Because you'd assume that the cost of fuel is higher and as well as the cost of transportation? And thirdly, if you could give us some more clarity on what is the difference between integrated and non-integrated production in the context of tissue papers? Thank you.

Sami Al Safran, Chief Executive Officer

Yes, sir. Good afternoon. This is Sami, the CEO of MEPCO. We have mentioned probably in our earlier interview, that our plan for this project is to go for a state of the technology meeting the future in Saudi Arabia into more digitalization more automation, less manpower intervention. Accordingly, we are proceeding with the European technology since the tissue technology is dominated in Europe, between Austria, Italy and Germany. So, most likely we are almost close to the final stage of selecting the supplier, we should be announcing it very soon, that regarding the technology supply. So, it will not be a secondhand machine. It will be a brand-new machine with the state-of-the-art technology. Coming to the second question about the Egypt costing structure. And like what's my colleague mentioned here, a major contribution part of the cost as the fixed expenses mainly from the virgin pulp supply. We believe due to that geographic location of Egypt closer to Europe, that gives them a slight advantage in terms of bulk purchases, which creates the differences in the shipping cost. Number two, it's from the labor side that has given them an advantage from that cost of manpower per ton of paper produced. However, that's when it's being mitigated from our side by the competitive energy costs. And finally, regarding the difference between integrated and non-integrated, some of the converting mills in Saudi Arabia are backward integrated. For example, one of the local mills here, they have their own paper mill actually the

only one in Saudi Arabia. They have their own paper mill and converting units, we consider them as integrative mills. However, some of the converters actually are having only converting units in Saudi Arabia, but the tissue mills are located outside Saudi Arabia. And yes, we are considering them as an integrated mill. Because we are in our marketing study, we anticipate that the opportunity of conducting business with them is limited. It's not impossible, but it's limited. And accordingly, we have identified that the available business for MEPCO for the new project is 150,000 tons locally in Saudi Arabia against that designed installed capacity of 60,000.

Anup Fernandes, SICO

Okay, just to understand this, so this new world project MEPCO, will be producing jumbo rolls, and then from the jumbo rolls, we'll be producing tissue paper boxes, right. And what happens in a non-integrated is that the firm just procures jumbo rolls and slices them into tissues Is that correct? In a very simplified way.

Sami Al Safran, Chief Executive Officer

It is correct for the second part for the first part of the project now is targeting to produce jumbo rolls for the first stage. Like what my colleague mentioned here, we had our own strategy. And definitely we will decide based on the business trends and demand. However, the like what they said, the main integrated converters are big enough in Saudi Arabia to accommodate the produced jumbo rolls, we will try to avoid competing with our targeted customers, unless there is a change in the market direction. Okay,

Operator

Thank you. Our next question comes from Mr. Ziad from Al Rajhi Capital.

Ziad, Al Rajhi Capital

Thank you for the call. You mentioned that energy is one of the main reasons for the competitive advantage for Saudi producers. I have two questions regarding the statement. The first one what kind of energy do you use, and the second one is if the government cuts the subsidies on energy, how it will impact your margins, especially after like the government, I think mentioned that they by 2025, they will remove the subsidies on energy.

Sami Al Safran, Chief Executive Officer

To clarify, actually, we did not mention the energy only as one of the advantages. The reality why MEPCO went to this business opportunity, may be for the reason of the low inherited experience in the business itself. We in MEPCO are having get two decades of experience of being a competitive producer of paper in the Middle East region, and also in the international market, we are on the second tier of cost competitiveness. We had our own experience, majority of the key from the board side to the executive management side are already having their experience in that field, rather some of us contributed in building a new project in Saudi Arabia and nearby markets.

So, the local experience of the business in MEPCO in paper industry and a tissue. The second main advantage is actually in this business is number one difficulty the energy competitive costs, but also the logistic advantage that we have. It's very clear from the existing business we have and from the potential tissue project, located in the western region of Saudi Arabia gives you the privilege to be closer to your customers in the western region and the in middle region of Saudi Arabia, which is actually dominating 70% of the market.

The second thing is they imported foods of producing materials will be always more competitive than shipping the goods to the Gulf. So, the second, so technically, here, we are talking about three main advantages, logistic advantage, expertise in the industry's and number three is the energy.

And finally, always, when you enter of with a new machine with a new technology, you will have the privilege among all levels from the term of direct material consumption to the operational energy. And this is why I mentioned from beginning that we are targeting to get them to go for a new machine, a state-of-the-art machine, understanding it, finally answering the effects of the energy. The main reason why we have selected the project location to be at KAEC is the availability of natural gas. And most of the gentleman here is aware that the natural gas internationally represents 50% of the cost of oil. So that means technically even the subsidies if it's been lifted from the energy supplies, it will not be as negative as the case of the liquid or fossil fuel. And this is what we have actually considered from beginning and drives us really to decide on this one. In addition to that, when of course natural gas by its nature, it's a key fuel, is it least contributing to the to the contamination of the environment. Lastly if you can see the investment, we have already planned for a cogeneration plant. And this is something that MEPCO are very good at where we build cogeneration plant to just the double the utilization of energy efficiency. In normal grid connection, the energy will cost you for example 18 halalas, whereas our model here we are talking about less than 12 halalas. Assuming the energy subsidies will be lifted, even if you add to 100% you will be more competitive than the international market.

Ziad, Al Rajhi Capital

So just to follow up it's a source of energy is natural gas, not a fuel oil or any kind of liquid oil, liquid fuels.

Sami Al Safran, Chief Executive Officer

Its natural gas and the project will be equipped with that cogeneration plant to produce the required electricity entity.

Operator

Thank you very much. Our next question is a text question.

What would be the expected annual revenue and gross profit margin of the new machine?

Bassem El Shawy, Head of Strategy and Business Development

Okay, thank you for that, we have to be confined by the amount of information disclosed already opted out. And since we did not announce that clearly on the level, we cannot discuss it today. But on the other hand, we have announced the design capacity for the for the new machine. So it will be easy for you to calculate on the back of the envelope number for you and to estimate the revenues. Unfortunately, we cannot disclose that now as we have to make public disclosure about the business plan as we progress throughout the phases of respecting the person.

Operator

Okay, thank you. We will now have a reminder for the questions. If you have a question, please press star two on your telephone keypad and wait for your name to be called that star two. If you are doubting via the web, you may also ask a question that is voice or text.

We have a follow-up question from Mr. Anup Fernandez from SICO please go ahead, sir, your line is open.

Anup Fernandes, SICO

you know on the cost side, now when containerboard the cost of base paper is roughly about 30 to 40% of the price of a containerboard. How what is the ratio of the cost of pulp to the cost of tissue paper that, in an approximate range would be very useful.

Mohamed Darweesh, Group Chief Financial Officer

Significant portion of course, it's sort of result as the that is from 65% up to 70%.

It represents about 65% or up to 70% of total costs of goods sold. However, in containerboard, it's ranging from 55 to 65% of the total cost of goods sold.

Anup Fernandes, SICO

Now this is you're talking about the variable cost right. So, all the entire variable cost is

Bassem El Shawy, Head of Strategy and Business Development

Yet yes, yes.

Anup Fernandes, SICO

Okay, okay. Okay. Thank you.

Operator

The next text question is from Mr. Abdul Rahman from Derayah Financial, when should we expect the commercial operation for this plant?

Bassem El Shawy, Head of Strategy and Business Development

Okay. We are starting the project in the first quarter of 2021 and we are looking to finish the construction by the end of 2022 and starting the test rounds in 2023. So, according to our plan, now, we should start seeing the enclosed in the second quarter of 2020.

Operator

Okay, thank you. We have another question coming from Miss Al Rasheed from Jadwa Investments. Does this mean that you are no longer considering your large expansion in containerboard? Or is this under review?

Bassem El Shawy, Head of Strategy and Business Development

No, it is under review for the time being, it has not been cancelled, but it is still under review to decide on the proper timing of the project.

Sami Al Safran, Chief Executive Officer

And I would like to comment on the subject like what my colleague Bassem mentioned here, we have developed our strategy earlier, we keep reviewing it and we keep identify the proper opportunities of MEPCO to move and to decide. And like with we mentioned, we keep prioritizing our activity based on what has into the viability of the opportunity that is available there. And accordingly, we decide. And now we have seen a great attractiveness in the tissue from both sides from investment, a quick execution, and a better return where we have decided and accordingly, we'll decide the risk. We mentioned earlier that MEPCO is looking from all directions, organic growth, horizontal growth and backward integration activities. And from there we will select really the best opportunities that had a stable, rational and a great return for the business and will move accordingly.

Operator

Perfect, thank you very much come it does indeed look like I am seeing no further callers. At this point, I'll pass the line back to the medical team for the concluding remarks.

Bassem El Shawy, Head of Strategy and Business Development

Thank you very much, everyone. Again, we are happy to substantiate our promise with facts today. We're happy to communicate you this positive news about our intention and how we plan to progress going forward with the MEPCO growth strategy. We look forward to further engagement with you, through roadshows, 1x1 meetings to explain further about this. And what is coming ahead in our strategy. Thank you. And please, if you have any questions, reach out. We're always available to answer any inquiries or questions you have. Thank you very much. Thank you.