

# MEPCO

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## CONFERENCE CALL DEDICATED TO MEPCO FINANCIAL RESULTS 3Q 2021

**Company:** Middle East Paper Company

**Date:** 01.11.2021

**Participants:**

- Sami Al Safran, Chief Executive Officer
- Johan van Vuuren, Chief Financial Officer
- Bassem ElShawyElShawy, Head of Strategy

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Operator:

Bassem, please. Go ahead.

Bassem ElShawy:

Thank you, Michael. Thank you very much, everyone for joining us. We will wait for a couple of more minutes to allow more people to join. We realize that there are conference calls for other issuing companies in Saudi Arabia at the same time. So, we'll give participants a few more minutes to join us. Thank you very much.

Bassem ElShawy:

Welcome. Good afternoon, everyone. Thank you for joining us today for the nine-month results call. We are going to start the call as usual, by making the disclaimer before looking at the statement. Management has made the effort to present a fair view of MEPCO's operations and financial performance. It is important to acknowledge that expectations about future results, the common line of preparing operational financial and market conditions, may change in the future. Management is, therefore, not held liable to explain differences between the expectations and actual results. Thank you very much.

Bassem ElShawy:

We would like to give you a very quick overview of the results of the nine months before we start today's call in details, and open for Q&A. So, it's of course a significant reporting period for us. We've seen results that were quite much unexpected by everyone and the achieving a top line of [inaudible 00:02:52], it's definitely a remarkable threshold for us to cross, and the bottom line of 126,000,000 in bottom line.

Bassem ElShawy:

It is not a secret that the paper price globally, especially for container boards have been on the rise, and it's backed by very strong demand on the commodity itself all over the world. In this region, and specifically locally also are seeing very healthy demand and price limits have been stable and taking a very nice shape when it comes to the future expectations of MEPCO, and that extends to the fourth quarter of this year. So, we're feeling quite confident, and I'm sure this is one of the main questions that you all have on your mind, when is the cycle going to turn, or is it turning quickly?

Bassem ElShawy:

From where we stand now, we see that this trend is stable and it's continuing for our visibility for Q4, at least now. So, we are looking forward for a very, very good and remarkable year. The margins that we are achieving are still a factor of many things. Of course, the price is one factor. The selling price. The other factor is the control over the cost of production. And last but not least, of course, the successors operations and efficiency initiatives that we talked about in the previous report.

Bassem ElShawy:

I am not going to dwell too much into the results, because I know you have a lot of questions. So, I would like to open the floor for you to ask these questions. Please go ahead. Thank you.

Operator:

So, thank you very much for the presentation. We'll now be moving to the Q&A part of the call. If you have any questions, please press star two on your keypad. That's start two on the keypad for any questions. You may also ask a voice or a text question online.

Operator:

We'll give a few seconds for questions to come in. Once again, star two for any questions. You may ask, also, a voice or text question if you are dialed in via the web.

Operator:

So just once again, reminder for any questions for the MEPCO team, please press star two on the keypad. We have the first from Mr. Jadish Bateeja from Lazard Asset Management. Please go ahead, Jadish. Your line is open.

Jadish Bateeja:

Hi, thank you for the call and congratulations on an amazing set of numbers. I would like to start with the top line. We saw strong uptick there. Would it be a mix of volumes and prices? And if that's the case, could you just give us a breakdown as to what percentage of the increment was due to strong prices, and outlook on pricing in the near term?

Jadish Bateeja:

Secondly, gross profit margins expanded, which I believe would lastly be, Ali had highlighted, efficiency in acquiring raw material. Have we seen the ban of exports of waste impact positively, and do we see more of this to come? What are the key drivers going forward? Thank you.

Bassem ElShawy:

Okay. Thank you. Thank you for this, for these questions. You are hitting all the important points. The growth on top line was mainly driven by the increase in price, rather than increasing in volumes. Volumes was fairly around the same level of last year. So, it's mainly attributed to price increase, of course.

Bassem ElShawy:

The question about the band. Let me just stress the fact that it is not the band, it's more of a filter regulation of the export of wastepaper out of Saudi Arabia. You can still export wastepaper out of Saudi Arabia, but you will have to go through a lot of filters to have this action done. It's something that is very rational, and it may make the market more regulated, but of course it is not banned.

Bassem ElShawy:

As we progress further, we are going to see the market looking healthier in that regard. And this of course gives us a great advantage of controlling the cost of production. We still follow the international trend of prices. We are not away from that. And collectively, we are looking at a very stable market when it comes to the OCC now.

Bassem ElShawy:

For the margins, this feeds directly into the margins question. So, for as long as we see this kind of control over cost of production progressing, which we expected to progress in the future, we will be able to carry these kinds of margins.

Bassem ElShawy:

Yes, and of course, the regulations in Saudi Arabia in general, they helped control the end product price also of containerboard.

Jadish Bateeja:

Sorry, could you repeat your last point terms of regulations?

Bassem ElShawy:

Regulations are twofold, basically. There are regulations that tap onto the end product and other regulations that tap onto into the OCC, the export of OCC. So the first part with regards to the end product, we have seen regulations about the specification of the container board or the definition of technical specifications for containerboards, which is something that came out recently and helped define the imports and the export flow of Saudi Arabia, and the trade mechanism all overall for the containerboard in Saudi Arabia, which was something that was a bit loose in the past. So, this of course added a lot of control and a lot of more regulation to the flow in and out for containerboards.

Bassem ElShawy:

Add to this, the part, as I mentioned, it is not a ban of wastepaper. It's the filter regulation of wastepaper. You can still export wastepaper out Saudi Arabia, but the requirements to do that are now a lot. Not like previously where this could happen easy. It is not easy to do that now. You have to satisfy local demand before you actually proceed with exporting wastepaper out Saudi Arabia.

Sami Al Safran:

Jadish, good afternoon. It's good to speak to you again. This is Sami. If I may elaborate to my colleague Bassem, about what is happening. See, in general, the containerboard industries packaging mainly is one of the classified industries in Saudi Arabia that is subject for damages from different things. One of them is the improper imports, improper specifications, metric standardizations, and also the open trade platforms for the raw material. And since this situation has been recognized by the different governments and institutes, there was actually different initiatives has been taken by the government to regulate and standardize the containerboard industry. So, we can actually be immune in the industry and make it to perform similar to the international peers.

Sami Al Safran:

So, in the past two years or three years, I think there was a different measure. One of them is, for example, the initial case of anti-dumping, which I think it's been followed by another announcement on the case. Also, we have that the SASO is moving aggressively to standardize the specifications of the finished product. And for the first time we could see really there is a local standard of specification of containerboard, which means any importers which they bring, they need to meet and exceed the specification, which really will help recreate the market and create a fair conviction across the deal.

Sami Al Safran:

I think the last one we have seen it actually is the regulation of the waste labor export, because earlier there was a mass export of waste labor to Asia, while the local industries were in the demand for, and then after the inception of the national waste center, they had started to assign, we call it an export licenses. So, importers now, before they ship the goods to outside, they need to approach the national waste center and get the license to export, which means local mills will be able to have access for the raw materials that they need for their operation before the collectors will proceed in exporting it.

Sami Al Safran:

I believe those initiatives which have been taken, can align with what we can see. The upward trend of the finished good prices. But from the other sense, we could find that this positive measure would really help to upscale the positive performance of our company through the company years. Inshallah.

Jadish Bateeja:

Great. Thank you. So, in short, it's safe to assume that third quarter margins are pretty much sustainable and not a one off.

Sami Al Safran:

Definitely part of this margin came to stay, and not cyclical like before. So yeah, the bottom performance will be definitely elevated up because I think we are just similar to the rest of the world, and there are a few mills internationally are performing and listed where we can have access to their information. So, we can build the platform similar to what we are expecting to see in MEPCO.

Jadish Bateeja:

Great. Thank you.

Operator:

Thank you very much. The next question is from Anas Al Safadi from SNB Capital. Please go ahead, Anas. Your line is open.

Anas Al Safadi:

Salaam alaikum. Thank you for the call, engineer Sami and Mr. Bassem, and congratulations on the results. I have a couple of questions. So, as you were told, my first question is on the prices. Of course, a quick background. This year has been phenomenal for your industry. It has been supported by supply chain bottlenecks globally, inflation as well, and authentication of the raw materials, gas prices have been increasing. How have you seen the paper prices trajectory from where we are today?

Anas Al Safadi:

Actually, as we speak now, a lot of analysts have been revising their let's say target prices or forecasts for international companies like IP. Mentioning that they don't see prices of containerboards, of course it's an integrated mill, IP, but they don't think that 2022 will be a year where there will be significant increases in prices going forward. So, your thoughts on the prices.

Sami Al Safran:

Okay. The second question.

Anas Al Safadi:

Oh, okay. My second question is also on prices. I would like to know the price discovery. So how long does it take for management, for you, to let's say witness that prices are weakening, right? Because container prices are not widely available. They're not quoted on an hour-by-hour basis. How fast can you detect prices reverting? Let's say. That's my second question.

Anas Al Safadi:

My third question is on the 25,000,000 G&A. I'd like to know what's the nature of increase in the G&A. My final question is on the ESTIDAMAESTIDAMA, and if you can quantify ESTIDAMAESTIDAMA for us, that would be good.

Sami Al Safran:

Alex. Thank you very much for joining. You always have really valid questions to be contributed. And probably also, I think part of your questions will be covering also the question raised by our friend Mr. Ali Jariwala about the outlook of the containerboard prices in the coming market.

Sami Al Safran:

Usually, classically we could see really a four-year cycle of price trends between ups and downs. And we have seen between 19 and 20 downward trends. And classically, we should be seeing, in the 2021, 22, an upward trend. The only difference we have seen it here, that the upward difference of the prices of containerboard went aggressively very high during the year. And this is actually not only specific for the

containerboards. Rather, we have seen it for different type of commodities, including timber, some of the other [inaudible 00:17:36].

Sami Al Safran:

So, the rate of increase went very high, which classically if we copy and paste the cycles, it's a cycle that should remain for 2022. However, honestly speaking, there is no right answers because it has been driven actually mainly by the inventory for the customer side, which dictates the increase of the demand. And also, the availability of new capacities comes on board.

Sami Al Safran:

It is important to note that during the pandemic, a lot of mills they have reduced their operating rate and they bring it below 85%. Which we believe in the 2021, most of those mills they have started increasing their operating rate and fulfilling their capacities, which they need the market. But still, we have not seen really a saturation in the market, and I think it is no secrets to everyone that the supply chain challenges that the whole globe is facing, it is creating a great interconnectivity of the commodity prices that, sometimes you might find a minor dip and then pick up again.

Sami Al Safran:

For example, we could see an indication of a dip into the [inaudible 00:18:50] prices. You could fulfill orders, but there is no guarantee that you get the material on time. So, I would say that with this increase of [inaudible 00:18:59], I could see or anticipate that a too stable, or probably an upward trend quarter is happening between Q4 and Q1. Definitely, it's very difficult really to assume Q2 how it's going to behave.

Sami Al Safran:

Now, coming to the second question, is that how we detect it. Probably part of my answers was that one, and this is that we usually see the different inputs that really indicate a downward trend, and one of them is that a new capacity, closure, energy prices, supply chain and logistics inventory, which really tells anybody that there is a clear indication of an upward trend or a downward trend. Probably this will be here for almost like two decades running our businesses. The team, they are very actively monitoring what was happening, and we predict, but definitely like any other human nature, we have our own mistakes and fault that we are doing. Without definitely ignoring that you are stationed in the geographic spot that has its own advantages, challenges, and uncertainties. So that's really dictate our prices in the local market, and in the international market.

Sami Al Safran:

Before I give the discussion to my colleague, we were meant to speak about the G&A. I'd like to really provide you some quick tips about the businesses that have. Number one is [Jizur 00:20:30], the tissue project. Jizure, like what we had announced a couple of times, we had selected the technologies supplier. Two weeks ago, our team was there to visit the sites, and to witness some testing of our manufacturer's equipment. We have all the licenses needed. Now we are actively negotiating with a separate contractor. We are targeting to break the ground within this quarter and trying to meet the target that we have announced to go for a commercial operation of testing by the Q4 2022.

Sami Al Safran:

The second one is ESTIDAMAESTIDAMA, like what we had explained earlier, it is the first project between a private sector and government that will manage the recyclables market specifically on the Jeddah city. Jeddah municipality have the conditions of the material being the owner of the generated waste. ESTIDAMA, represented by WASCO, have the technical know-how and the financial capabilities.

Sami Al Safran:

The last week of September, we have immediately kicked our operation in Jeddah. Thankfully we reached up to our target, the startup target, by 100%. Reaching to [inaudible 00:21:49] tons. We are targeting for ESTIDAMA to build a secure material for us on the average of 140,000 tons a year, and the new regulations and controls and requirements of the Saudi division for the total circular economy and waste management. It's really premature to identify. Of course, we have some potential expected bottom-line numbers and top line numbers, but until really, we set up the company and make it in a fast pace of operations, it'll be really difficult to mislead you with any information about the expected performance.

Sami Al Safran:

I would leave now for Mr. Johan to explain the increase in the G&A.

Johan van Vuuren:

Good afternoon, everyone. I'm asked with reference to your question around the 25,000,000. The majority of the increase once of item. You will recall from the announcement and disclosures made on the financials that the employees share options scheme that has been in place for a number of years, following the shared buybacks and treasury shares held. The grant date of those shares was 1 July 2021, following the board's approval.

Johan van Vuuren:

Now under IFRS, you need to circulate that through your income statement at the fair value of the shares at the grant date. So, the majority of the employee share option scheme expense that was circulated through the income statement, went to the G&A. So, the majority of the increase relates to that. The balance of the increase relates to variable performance-based compensation, and the balance of our G&A remained on the same levels as they were the previous year.

Anas Al Safadi:

Okay, sure. Just to clarify, we have 10.2 million Riyals worth of shares, and correct me if I'm wrong, they just got vested today, and that's why we need to expense them through the P&L, right?

Johan van Vuuren:

Yeah. So, under IFRS, you hold the treasury shares, the amount gets circulated through your P&L at the grant date, and the grant date is defined by IFRS as the date at which your board approves. So accordingly, to calculate the 10.3 million, it's quite simple. It's the market value MEPCO shares as of 1 July, 2021 multiplied by the 300,000 shares.

Anas Al Safadi:

Thank you, gentlemen, for the clarification. Thank you.

Johan van Vuuren:  
[crosstalk 00:24:38].

Operator:

Thank you very much. Our next question comes from Ashar Saleem from FALCOM Financial Services. Please go ahead, Ashar. Your line is open.

Ashar Saleem:

Hi, thanks a lot for the call, guys, and congratulations on the great set of results. I have a couple of questions. One is the buyback and the treasury shares that you mentioned. If I'm not mistaken, there's always a provision for these kinds of benefits which get charged every quarter or every year. So, all of the impacts coming in together, that's something that's astonishing. That's one. Secondly, do we have more treasury shares? What's the current number of treasury shares held by MEPCO as of now, which are part of the employee incentive program? That's two. Lastly, on the tissue factory that you mentioned. If I'm not mistaken, you said quarter four, 22, we will start the trial runs, or the commercial operations will begin in the fourth quarter 22? That's it

Sami Al Safran:

Let me answer the last part since it's related to me, and then Johan can explain the rest. Regarding the tissue, it is announced that the trial run by the Q4 2022. Classically, in our labor industry although we declared the trial run, but we try majority of what has been produced to be in a commercial level, but we were kitted for uncertainty purposes. We chose the trial run until really, we build the full confidence and the full operation care of the tissue man. I leave the rest to be explained by Johan.

Johan van Vuuren:

Okay, so you had two questions with regards to the treasury shares that were held. Your first part of the question relates, let's call it, to the old program. So contrary to what you suggested that these get accrued on a quarterly basis, it's not the case. So up until the end of last year, and up until the end of the previous quarter of this year, you would've seen disclosures made in our financial statements that the shares were bought back in 2018, actually already. So, we were carrying those for a number of years on the balance sheet. And as I said before, the grant date of those shares become the point at which, under IFRS, you can circulate those through the P&L. So, the full 10.3 million hit the income statement in the current quarter.

Johan van Vuuren:

So, with regards to the second part of your question, you will see most, if not all, these shares fizzle out of the treasury shares by 31 December. That indeed relates to the old program. We are currently evaluating a new program for the next couple of years. Once we've received approval from the board and its subcommittees, we will start a new share buyback program, and of course you'll be notified as and when those things are approved.

Ashar Saleem:

If I can have a follow on that. For the buyback, okay fine you have something in the pipeline. In terms of dividends, do we have something coming up by that side or we are off that.



Johan van Vuuren:

Okay. So, with regard to the dividend, as I said in the previous quarter, we committed to the board that we would present the board for approval and then the annual general assembly with an updated dividend policy that will provide more stable dividends returns to the shareholders. We will, if not prior to the end of the year, very soon following year end, communicate our official and updated dividend policy to the market.

Ashar Saleem:

Thank you.

Operator:

Okay. Just once again, a reminder for any additional questions, please press star two. We did get a text question from Mr. Ali, which I believe was already answered previously. Can you give an idea about the global containerboard market situation, the outlook for next two to three quarters? Which I understand already has been answered. We'll just give another few moments for the questions to come in.

Operator:

Okay. It looks like there are no further questions at this point. I will allow the MEPCO team to give their concluding remarks.

Sami Al Safran:

Thank you very much, gentlemen, for having the confidence on us as the MEPCO team. We tried through the pandemic timing, which was, I think, very crushing timing for everyone. Where we have really worked hard to sustain the operation and utilize the timing actually to restructure the internals of the company through a very active restructuring in term of efficiency improvement, which thankfully I think the company was in a well preparation set up to capitalize the benefit of the price cycle, which actually led to a very healthy financial result. We will try to do our best to maintain these financial results through the time.

Sami Al Safran:

We are actively engaging all the stakeholders in the market with what we are doing, because we are very delightful to hear from Saudi Arabia, the green initiatives, the different sustainability programs, and finally also the waste management vision and objectives, and implementation plan, which I think those activities will really enable our business to sustain and grow. Since I think there's a lot to do really in terms of waste management. It's a green team, the project, and thankfully MEPCO has an experience over two decades through different practices by our own company of WASCO where we have built and operated a successful material recovery facility in different places. We have [inaudible 00:31:03] in different areas. We have worked in different segmentations. So, I think that really would allow us to capture those capabilities and translate them into a business approach.

Sami Al Safran:

I'm biased that in the coming few years, the situation from all angles will be much better than the challenges we are facing right now. Until then, please take care and thank you very much for your presence at our result event. Ladies and gentlemen, thank you again. And for those who had questions

asked, please reach out to us on [investors@mepco.biz](mailto:investors@mepco.biz). We would be happy to have a one-on-one call with you and explain all answers to your questions thoroughly. Thanks again, everyone.

Sami Al Safran:

A couple of questions that's coming here. We'll just pop up one of them. It's about the effects of Riyadh season and other events into the company. I think no doubt that really the increase of the number of populations from one side, and touristic activities, visitors, would always goes for the favor of enhancing the demands and the packaging materials, which actually we are the main suppliers of the packaging materials into the market. And we could see really physically that the actual growth and the demand from the local market after the normalization of the situation in Saudi Arabia, we anticipate by the increase of the visitors to [foreign language 00:32:39], Riyadh season, and other seasons will have definitely really an increasing the demand and accordingly will give us more focus.

Sami Al Safran:

Needless to mention that during the year to year, MEPCO has increased our market share in Saudi Arabia from 25% to 30%, trying to catch up as much as we can the local market and trying to meet the demand of the local market.

Sami Al Safran:

There is one question about the business overview. It's a bit really premature to spend the time with everybody here since our business is maybe serving the containerboard sector, from the integrated of collecting raw materials based on waste, to the level of manufacturing and delivering to our client base. We are a B2B business, and I think if there any other questions [crosstalk 00:33:40].

Sami Al Safran:

Thank you very much, gentlemen, and wish you all the best, Inshallah.

Bassem ElShawy:

Thank you very much, everyone.

Johan van Vuuren:

Thank you. You may disconnect your lines.

Operator:

Thank you. This concludes today's call. We're now disconnecting all the lines.