MEPCO Q2 24A Earnings Conference Call

Monday, 19 August 2024

Nour — Good morning and good afternoon, ladies and gentlemen, and thank you for joining us today. This is Nour Eldin Sherif and on behalf of Arqaam Capital, I'm delighted to welcome you to MEPCO's Second Quarter Results Conference call. I have with me here today, Mr. Rob Jan Renders, acting Group President; Mr. Amr Masry, EVP of Finance; Mr. Ahmed El Fazary, EVP of Commercial; Mr. Mohammed Elsherief, acting VP of Waste Cluster; and Ms. Hind Kaddoura, the new head of IR.

With no further delay, I will turn over the call to Ms. Hind.

Hind — Hello, everyone. It is my pleasure to introduce to you the H1 2024 earnings release.

To start with the disclaimer, this presentation is prepared by MEPCO, and contains basic information about company activity as of the latest published results. The information is presented in summary rather than detailed form. This information, including any forward-looking statements, should not be taken as basis for investment recommendation, solicitation for any of the company's tradable securities. While management has made every effort to present a fair view of MEPCO's operational and financial performance in this presentation, it is important to note that expectations about the future results that come in light of prevailing operational financial and market conditions may change in the future. Management does not recommend using such forward-looking statements in financial modeling or investment decision making. It first takes no liability to explain differences between future actual results and what was stated in the course of this presentation.

Joining me today are MEPCO's executives, Rob Jan Renders, acting Group President. Would you like to introduce yourself?

Rob Jan — Good afternoon, everybody. My name is Rob Jan Renders. Indeed, I'm a board member of MEPCO since November '22 and currently acting President or Group President. I have a long experience in the pulp, paper and packaging industry. I had 23 years active in SCA, a Swedish multinational company, and I had different roles, including the president of the containerboard, which is the paper organization, and later a number of years as president of the packaging group, with a turnover of 3 to 3.5 billion euros and some 20,000 employees and 200 plus operations across the European continent.

Later, I started as a consultant and worked for many internationally known private equity companies in different roles, board memberships, but also as acting presidents or CEOs in a number of occasions. So currently, I'm here for the time being until the board finds a new successor to Swami, the previous Group President.

Hind — Thank you. In addition, our EVP of Finance, Amr Masry; our EVP of Commercial, Ahmed El Fazary; or our VP of Waste Management, Mohammed Elsherief are also joining the call.

We will begin discussing the H1 2024 key performance indicators. We will have a macroeconomic review on Saudi Arabia and discuss the industry and market containerboard and tissue. We will discuss export and local sales financial review. And finally, we will discuss management outlook.

To begin with, the first six months of 2024, the year to date, our sales revenue reached 498.5 million, an increase of 21% year-on-year. Our gross profit reached 86.7 million, an increase of 49% year-on-year. Our EBITDA increased by 31%, reaching 49.7 million. Our net loss to parent decreased by 49% since last year reaching a loss of 15.2 million, and cost of sales reached 411.7 million after a 16% increase from last year.

When it comes to margins, our gross profit margin increased by 334 basis points to reach 17, our EBITDA margin increased by 80 basis points to reach 10%, and our net income margin increased by 417 basis points to reach minus 3%. When it comes to utilization rates, MEPCO utilization rate was 92% and [indiscernible 04:56] utilization rate is 80%.

For a macroeconomic review on Saudi Arabia, according to the general authority for statistics, real GDP decreased by 0.4% in Q2 2024 compared to Q2 2023. This decrease was primarily driven by an 8.5 decline in oil activities, while non-oil activities increased by 4.4% and government activities grew by 3.6%. According to the World Bank, real GDP is expected to grow by 2.5% in 2024 primarily driven by non-oil activities.

For the containerboard market, MEPCO's current market share remains at 30% in Saudi Arabia. The global containerboard GDP estimates for 2024 are $123,024 billion. For MENA, it's $5406 billion. And for Saudi Arabia, it's $1786 billion.

In 2024, fast market VC previously forecasted a 4.2 demand growth. However, revisions at the beginning of the year down to 3.3% in containerboard demand growth, which is lower than what is expected for Saudi Arabia. The Saudi Arabia demand growth for recycled containerboard is 4.10% for 2024 and for virgin containerboard it's 6.7%.

Some of the reasons for this increase of demand include the growing Ecommerce sector, as well as a focus on sustainable packages. The prices for OCC that we track are Europe and the ones that we export to India. These two have had an increase from Q1 around $25 to $50 US per ton, reaching $229 for the OCC export to India, and $151 for OCC Europe.

When it comes to test liner and fluting, it's important to note that this is around 66% of the total sales volume that we sold in Q2 23. We see also a market recovery, with the upward trend persistent in Q2 2024 with an increase of roughly $30 to $50 US per ton for both test liner and fluting.

For the tissue market, the global tissue consumption is around 44 million tons. In Saudi Arabia, it's 250,000 tons. The average global demand growth expected for 2024 is 2.3%. And once again, Saudi is expected to have a higher demand growth reaching 3.5%. When it comes to the Juthor operations, management expects net income of 21 million by the end of 2024 and an expected gross profit margin between 23% to 25%. Our targeted market share remains at 28%.

Juthor's product pricing is directly linked to the cost of importing virgin pulp. There's an increase between the bleached hardwood kraft and a softwood kraft since last quarter, since the beginning of a year of 32% or an average of $300 to $400 US per tons, with the hardwood kraft reaching at $1,380 and the softwood kraft reaching $1,597.

It is important to note that numbers starting from Q1 2024 onwards include containerboard operations tissues as well as sale of other recyclables.

The sales volume, quarter-on-quarter increased. Export sales increased by 30% while local sales decreased by 7%. It's important to note that this increase in 30% in export sales is as a percentage of revenue. So there was an overall decrease in sales, not an increase in export activity.

Year-on-year, export sales decreased by 44% and local sales volume increased by 30%. When it comes to the sales value, quarter-on-quarter there was an increase in 20% on the sales value of exports and a 5% decrease on local sales. And year-on-year, there's a decrease on 47% on export sales value. This is due to the rising shipping costs due to the Red Sea shipping crisis currently we are facing, and an increase of 30% local sales value.

If you look historically, we used to export around 30% to 40% of our sales and sell domestically 60% to 70% of our sales. In Q1 and Q2, this ratio changed and we decreased our export sales due to the current Red Sea shipping crisis.

A financial review, our sales revenue increased by 5% quarter-on-quarter. This increase is primarily attributed for the increase in price of 14% and a decrease in quantity of 8%. Year-on-year, revenue increased 21%, reaching 499 million. This increase in 21% is attributed to 13% increase in sales quantity. The sales quantity is primarily attributed to Juthor and a 6% hike in selling prices.

When we look at gross profit, gross profit increased by 67% reaching 54.2 as well as the gross profit margin also improved from 13% to 21%. This increase in gross profit margin is due to the operational efficiencies that we currently underwent in our Juthor operations, where we switched from diesel to natural gas, which really impacted our profitability margins. Other reasons for an increase in gross profit margin include the decrease in cost of sales, primarily of fiber and production overhead costs.

Year-on-year, we increased our gross profit by 49% reaching 86.7 million. And also, we increased our gross profit margin from 14% to 17%. Also due to the higher sales volume, thanks to Juthor, and higher margins thanks to the switch we currently underwent.

When it comes to cost of sales, our cost of sales decreased by 5% reaching 201 million. This is broken down into 33% fixed costs, which went up by 3% from last quarter; 22% variable cost, which went down 1% from last quarter; and 45% fiber cost, which means the raw materials, which went down 2% from last quarter. Year-on-year, our cost of sales increased by 16%. This increase in cost is primarily attributed to the new Juthor operations that we discussed and the higher sales volume that we are currently selling. The breakdown of this cost of sales year to date is 32% for the fixed cost, 23% for other valuable costs, and 45% for the raw materials.

EBITDA also showed a positive increase of 124%, reaching 34.4 million, as well as the EBITDA margin from 6% to 13%. This improvement in EBITDA is attributed, again, to the sale of tissues as well as other recyclables and cost optimization initiatives. EBITDA year-on-year also increased 31% reaching 14.7 million, and the EBITDA margin increased from 9% to 10%.

Our net loss decreased by 119%, and after five consecutive quarters, we closed the quarter net positive of 3.5 million, an increase of 22 million from last quarter. Year-on-year net loss decreased by 49% driven by the additional sales that were for Juthor and cost optimization initiatives.

If we look at the net profit breakdown this quarter versus last quarter, as we discussed, our revenue increased 5%, which is equivalent to 11.6 million primarily attributed to 14% increase in sales price and a decrease in quantity of 8%. Our cost of sales decreased by 5% due to the operational switch that we did from diesel to natural gas in Juthor.

Our selling and distribution expenses increased by 10%. General and administrative expenses increased by 1%. Our impairment losses are due to ECL model reversal of impairment of 3.96 million. Other income includes 1.5 which increased by 1,196%. This is attributed to the profit on fixed deposits. And net loss decreased by 119% or an additional 22.5 million, closing the quarter profitably.

Looking at the net profit breakdown year to date, our revenue increased by 21% or 85.21 million. This is attributed to 6% an increase in sales price. However, the higher impact is the new Juthor operations and the larger quantity sold. Our cost of sales increased by 14%, again due to the Juthor operations.

Selling and distribution costs increased by 4% due to the Red Sea shipping crisis. Our general and administrative expenses increased by 15% due to an increase of operations and administrative related expenses for Juthor. Our impairment losses decreased by 4.2 million due to an increase in receivables and other income decreased by 79%, leaving us with a decrease in net loss of 49% or an additional 14.6 million.

So our working capital increased year-on-year by 284%, reaching 663. This 284% is primarily attributed to the proceeds of cash from the investment we announced in Q1 2024. Our working capital ratio increased from 1.4 to 2.2.

Despite the improved profitability, our cash flow from operations decreased by 98%. This is due to negative working capital changes. These are due to an increase in accounts receivable and increase in inventory, much higher than the increase in payables that we underwent throughout the year.

Our net debt to equity decreased by 101% due to the repayment of loans that we currently had, as well as the additional cash investment that we announced in Q1 2024. Net debt to EBITDA also decreased by 101%, also for the same reasons, reduced long term debt and increased cash reserves.

And finally, our management midterm outlook. The main priorities include strengthening our vertical integration. We recently announced that we're looking to acquire a corrugator to further enhance our vertical integration strategy, reach 100% production capacity for Juthor, expand our Wasco sale to others, grow sale of recyclable materials to external customers, and secure materials for our latest announced containerboard machine, which is expected to launch in 2027 and doubling our containerboard capacity. Finally, diversify product portfolio to cater to a wider range of customer needs and market segments. Thank you.

Nour — Thank you so much, Hind, for the presentation. We will now move to the Q&A session. So if you have a question, please raise your hand or submit your question in the Q&A box.

We have our first question from Salman. Please unmute yourself locally.

Salman — Good afternoon. This is Salman Haqwani from Raj Capital. So, first of all, congratulations on return to profitability. My first question is, compared to the expected figure for 2024 gross margin for Juthor, can we have the current level for Juthor for the gross margin?

Amr — Yes, I'll take this question. Currently, in terms of our gross margin for Juthor, because we have, yes, shifted to gas, but we're still not 100% operational on gas. We still use the connectivity until we stabilize the turbines. Our gross profit margins are ranging between 25% to 27% currently. We do expect this to normalize once we move 100% to the gas turbines.

Salman — That's a clear. Regarding moving 100% to the gas, do you have an expected timeline for that, or specific target time?

Ahmed — It's supposed to be within this quarter. That is just stabilizing the turbines and stabilizing the link. Some of this issue is not related. It is related to the current line of gas that we receive. Sometimes it stops because of the providers. They're still trying to stabilize the flow of gas within the line.

Salman — That's clear. So my second question is, is there any updates on the acquisition on the corrugate boxes for the users?

Rob Jan	This is Rob Jan speaking. We are currently in the process of assessing a number of potential targets, so we cannot disclose anything further.
Salman	That's clear. Thank you so much. That's all from my side. Thank you.
Nour	Thank you. Our next question comes from the Q&A box on when the acquisition will be announced. Again, same question from the Q&A box.
Rob Jan	You mean whether we will acquire in August?
Nour	It's a question on the timeline of the acquisition, because it was mentioned earlier that it would be completed by Q1 this year. That's from the Q&A box.
Rob Jan	We will not close the deal in August, for sure.
Nour	Okay, that's clear. As a reminder, if you have a question, please raise your hand. So we have our next question from Samir. Please unmute yourself locally.
Amr	Am I audible? Okay, I'll take Ahmed Elbermawy and Abdelaziz Awad questions regarding the prices. Thank you for attending today's call and thank you for putting your questions here. We expect prices to continue on the upward trend. Just shedding some light on what's happening in the industry globally, there has been price increase announcements from the end of Q1 this year, and they continue to be announced. Not all are implemented. There's back and forth discussions between buyers and sellers, because, as we mentioned in the previous call, the price increase predominantly was pushed by the increase in input costs. And I have to also highlight that there has been a slight improvement in the economic indicators and in the demand in most of the world regions. So we believe that the price will continue to at least will be stable to upwards. We don't anticipate any drop in price.
Nour	Thank you, Amr. We just have a question from Samir. Please go ahead.
Samir	Thank you, gentlemen, for the presentation. Question on your capacity utilization. You mentioned about 90% plus capacity utilization. I just want to understand about your competitors, how's their capacity utilization and how's the competition scenario in Saudi market?
Ahmed	Let me answer you from the top of my head, based on the statistics that we've been seeing globally. Unfortunately, most of our regional or all our regional competition, there's no published info about, so it's very difficult to share those numbers. But globally, operating rates have been well below us. Last year and this year continue to be well below us, with Europe being among the lowest operating rates in the late 70s percentile, maximum 80%. So we're still among the highest operating rates when you compare to other global players. And I believe it's also when you compare it to regional players.

Samir	Got it. Just to follow up. Do you think this kind of scenario can push down the prices, maybe will it impact the prices? Because I've seen in the last two quarters, we have seen a price improvement in the paper. So can this lower utilization impact the prices?
Ahmed	Look, it's highly unlikely that we see any price drops, because still input costs are quite high, and this is common among the industry. So no one have this room to reduce any prices, and demand is improving. And I also have to highlight the fact that we're already in the highest seasons in Saudi Arabia here, the summer season where there's a hike in demand of beverages, it's the date season, and we sense the heat from our customers. The demand is quite healthy, so I don't anticipate this on a domestic level.
	And on an international level, also, I have to highlight the fact that now in the preparation phase for the high season of the year, which is the Christmas season in the West. So I don't anticipate that prices would drop. And this is when I talk about prices. I'm mainly covering containerboard and paperboard prices. While commenting on the tissue side of the business, I have to mention that we've seen some drops in pulp prices, so this might be a slight driver for normalization at least of selling prices of tissue.
Samir	Oh, that's very clear. Thank you so much.
Nour	Thank you. We have a question from Hamad Al Talib from the Keone Box. This first question is, “Is it fair to assume a similar Q-on-Q jump in net profits assuming the natural gas line to Juthor proceeds as expected in Q3 of 2024? And his second question, “Any update on the Waste Management pipeline?”
Ahmed	I'll take the first one, the first part of the question, and I'll leave the second part of the question for Mohammed to take it.
	For the first part of the question, we have a strategy put in place, and we have a plan on a short term and a long term. In the short term, our target is to continue increasing our sale quantities and our production in Juthor to reach the maximum capacity. This should certainly enhance our top line with the improvement of the shift, 100% shift to gas. This, again, would help us continue our cost efficiency plans that we have committed to since the beginning of the year. We also have committed to diversifying our product line and increasing our sales and recyclables. We have doubled almost our sales and recyclable materials. All of this have previously contributed positively to our performance and have moved us from a loss to a profit. We will continue doing the same until the yearend.
Nour	On the second part of the question on the Waste Management pipeline.
Mohammed	Okay, as we announced earlier, in terms of growth, we are focusing in two things. The first part, which is strengthening the core of the business. What we are currently doing right now, the second part, it's expand into the waste management. When it comes to strengthening the

core of the business, we started enhancing, diversifying our supply chain when it comes to acquiring material. That's why we are trying to not focus only on the fiber to make good, but selling to others as well as enhancing the other recyclable material like the plastic and steel and other material.

We are continuing on our geographical expansion, specifically when it comes into a partnership with the local government. Earlier of the year, we have announced our nm partnership with Mecca, which is we are trying to finalize this into a solid agreement. The thing is, is try to replicate, to do on a kind of private, public partnership with the government, getting their leverage while we strengthening our supply chain arm when it comes to recyclable acquisitions. This is the first part.

Second one, the waste management, one of the projects we were working on with the government, which is the waste to energy, we got an initial green light on the wastewater energy. Still, we are in discussion of the final number and the timeline. If this suit us, I believe we'll be in a position to able to announce the projects. If not, I believe we will park it aside. But what we are getting from the government so far, it's a green signal on the project's concept. Now the next stage is to finalize the number and the timeline.

Nour That's clear. Thank you. The next question comes from Abdelaziz. "Given the current improvement in pricing, do you expect the current gross profit to be maintained for the rest of the year?"

Ahmed I think we've just answered that question. We have put in place a plan and a strategy for our short term and our long term. On our short term, we've committed to increase the quantity sales, particularly in the tissue business, diversify our product portfolio and enhance our costs. We have seen that this has impacted positively on our results. We've flipped the results from losses to profits. We will continue engaging in the same and implementing our plan until the yearend.

Nour Thank you, Ahmed. That's very clear, another question from Ayub, a broader question relating to waste collection. "How far are we in terms of regulation with the government mandating households to segregate waste as is done in UK and Europe?"

Mohammed Look, in terms of regulation, there now is the remaining part, the real execution on the ground, which is there is an active discussion in the government. This shouldn't be quoted that we are responding on behalf of the government, but we told you the update which is going on, being an active player in the market.

There is an active discussion on when it comes to source segregation, but yet has to be enforced when it come to the new cycle of the projects, where the government, they are discussing three streams, been on the street. But yet, this is not in terms of implementation not really realized.

What is really active, which is we are part of it is an EPR scheme, the extended producer responsibilities to enhance further recovering the material. But yet, there is no implementation. It's just an active discussion, which they are trying to realize this by 2025.

Nour Thank you, Mohammed. That's clear. As a reminder, if you have a question, please raise your hand or submit your question in the Q&A box. Until we have our next question, can you share some light on the reason behind the increase in OCC costs, the chart that you have shown with the jump recently?

Mohammed As we were saying before, that's in Saudi Arabia, the whole GCC, and specifically in Saudi Arabia being active there, there is a price war in the last quarter when it come to the price, specifically because of the active export of the OCC to India, though there is a multiple discussion on this. And as we said, usually India paper mill, they are getting their holiday in August. Now what I heard they extended it and they will be stopping in October or November. So there is an erase regarding stocking material and the paper mill, which has led to a price increase in the market of the OCC.

So what we are trying to do now, we're controlling this by gaining the control over the market and strengthening, as I said earlier, our supply chain arm by doing a partnership with the local government, in addition to our active discussion with the export, the Saudi Export Authority, and of the industry.

Nour Clear, but this is not a global trend. That's only for Saudi and India?

Mohamed Now, if you see it's a global trend as well, like if you see the chart where hand were showing in the presentation, in Europe it shows increase on the price. If you see, yes, the gray one. And the one to India, for sure, it was showing increase as well. And why I mentioned export India, because this is really the main factor is affecting the price and the whole GCC. But globally, both of them, you are going into the increment trend.

Nour Clear. So it's a global push then?

Ahmed It is. But as I said, yes, GCC mainly always headed by the export to India. When there is no export to India, then the price starts to go down or to be stabilized. But for sure, it is always linked to an international indicator as well. But the main head is the export.

Nour That's clear. Thank you. And can you share with us how much of revenues were generated from recyclable metals in Q2?

Ahmed Around 6% of the revenue for the current year versus last year has been generated from recyclables. That is 20,298 tons, actually, versus 6728 tons that were only sold for the same period last year.

Nour That's clear. And what's the target for full year?

Ahmed The target is to have a supply of other material of 5000 per month, which translates to 60,000 per year.

Nour Amazing. Thank you. We have another follow up question from Samir. Please unmute yourself locally.

Samir Thank you. Just a follow up question. I think almost 600 million plus reals of cash is sitting in your balance sheet after the PI of investment. So how do you want to use this cash? Any capex planned for?

Ahmed Yes. So if I understood your question clearly, the allocation of funds that we've received from PIF, the funds that has been received from PIF are allocated to three main projects. Our expansion plan in the containerboard, we're doubling our containerboard capacity. Then expansion in the tissues, we're doubling also our tissue capacity. And to the acquisition that we're looking at in the corrugator board market. In terms of split, that is almost 1/3. You can see the detailed split in the PIF prospectus that has been issued, but it's almost 1/3 the word the expansion plan in the containerboard, 1/3 to the tissues and that's like 50%, then 25%, 25%, that's 1/4 actually, and the 50% will go to the acquisition.

Samir Okay, that's clear. And with regards to your export market, how profitable is the export market versus local?

Ahmed Samir, I'll take this one. If you look at the presentation, you'd see that our export savings have dropped significantly in the past few quarters, basically due to the Red Sea crisis, which inflated trade costs very high. And this is what we always try to claim that we're an agile company, that we are able to maneuver in a very quick manner from one market to another. So as you've seen in the presentation, we shifted from 60% domestic sales to 80% of domestic sales, while the 20% remaining sales export sales were basically to export markets with logical proximity and freight costs. So our export orders, we always try to maintain a fairly profitable margin, and we start maneuvering accordingly.

You'd see also going forward that our export sales start increasing bit by bit, where we start reaching to areas where we or markets where we had to reduce our share in due to relatively lower freight rates. Still, overall, freight rates still continue to be high, but they are competitive as opposed to when the first Red Sea crisis occurred.

I hope I answered your question clearly. Please feel free to ask.

Samir Yes, that's very clear. Thank you so much.

Nour Thank you. So there are no further questions in the Q&A box and no hands raised, so we will hand the call back to Hind for any conclusionary remarks. Thank you.

Hind	Thank you, everyone, for joining the call.
Nour	Thank you. This concludes our call for today. You may now disconnect. Thank you.