Transcript

MEPCO Q3 24A earnings conference call

Wednesday, November 20, 2024

Nour Eldin Sherif This is Nour Eldin Sherif, and on behalf of our Arqaam Capital, I'm delighted to welcome you to MEPCO's third quarter results conference call. I have with me here today Rob Jan Renders, acting group president, Amr Masry, EVP of Finance, Ahmed Fazary, EVP of Commercial, Hind Kaddoura, IR manager. With no further delay, I will turn over the call to Hind.

Hind Kaddoura Good morning, or good afternoon, everyone. Thank you for joining us on this earnings call. I'm Hind Kaddoura, head of Investor Relations, and I'm excited to share an overview of our company's performance for Q3 2024 and provide insights into our progress, challenges and future plans. Before we begin, I'd like to thank our team, stakeholders and partners for their continued support. Let's dive right in.

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Joining us today, MEPCO's executives, Rob Jan Renders, acting group president, Amr Masry, EVP of Finance, Ahmed Fazary, EVP of Commercial. Today's agenda, we will begin with nine-month 2024 KPIs, our macroeconomic review on Saudi Arabia, and we will dive in deeper into the industry and market review on containerboard as well as tissues. We will discuss our exports and local sales, financial review, and finally we will conclude with the management outlook.

Key performance indicators. For the first nine months of 2024, our sales revenues reached SAR 775.4 million, an increase of 21% from last year. Our gross profit reached SAR 136.6 million, an increase of 66% from last year. EBITDA 64.6 million, an increase of 19% year on year. And the net loss to parent was 32.8 million, 26% lower net loss from last year. And cost of sales increased by 14% to reach 638.8 million. When it comes to margins, our gross profit margin reached 18%, versus 13% last year, an increase of 484 basis points, EBITDA margin was at a stable 8%, and net loss margin decreased by 270 basis points, so from minus 7% last year to minus 4% this year.

Macroeconomic review. The real GDP growth rate in Saudi Arabia for Q3 2024, as per the General Authority for Statistics of Kingdom of Saudi Arabia, is 2.8% compared to last year. This growth is attributed mostly to non-oil activities that saw a strong growth of 4.2% compared to last year, as well as government activities that showed a positive growth rate of 3.1%. Oil activities recorded a more modest growth of 0.3%. According to the World Bank, following the contraction witnessed in 2023, real GDP is expected to grow by 2.5% in 2024, driven primarily by robust non-oil private activities.

Industry and market containerboard review. As per RISI Pulp and Paper, 2024 containerboard estimates globally are around 190 million tons, for the Middle East, 3.25 million tons, and for Saudi Arabia, 1.5 million tons. Given the fact that MEPCO's current production capacity is around 450,000 tons, we can safely say that MEPCO's approximate current market share is around 30%.

If we look at the graph on the left, the expected containerboard is expected to grow at an average of 3.4% year on year until 2027, reaching 3.7 million tons for the Middle East. MEPCO will be taking advantage of this increase in total addressable market by expanding its production line with the new plant, PM5, which we previously announced. It's designed to double containerboard production capacity to 900,000 tons. Updates on PM5. MEPCO has partnered with Voith and is currently finalising the design phase, with ground-breaking expected to commence before the end of 2024. Funding exceeding 1 billion has been secured.

When it comes to the raw materials, OCC, they have significantly fluctuated over the past two years. However, from the beginning of the year until now, they have shown a consistent growth, whether it comes for OCC in Europe or OCC which is exported to India, which is the closest to us. Reasons behind this growth include the growing e-commerce sector and increasing focus on sustainable packaging.

For the containerboard prices, we see there is a very similar downward and upward trend between Europe and GCC. We are following test liner and fluting, which represent around 61% of the total sales volume for the year-to-date. Strong average growth since Q4 2023, all paper categories have shown significant increase during the year, with PIX fluting leading the way with a 22% increase, followed by test liner Europe, 20% increase, fluting GCC 18%, and test liner GCC 16%.

Industry and market tissue review. As per RISI Paper and Pulp, global tissue consumption is around 44 million tons. Saudi Arabia is 250,000 tons. MEPCO's current production capacity since last year is 60,000 tons. MEPCO's current market share, 24% of Saudi Arabia's market. Now, when we talk about tissue, we mean kitchen towels, facial tissues, pocket tissues, napkins, C-folds, etc. The world tissue demand growth is around 2.3%. There is a higher expected growth for Saudi Arabia, which is 3.5% year on year, which would mean that we would reach circa 300,000 tons by the year 2027. MEPCO also plans to capture part of this addressable market by doubling its current tissue capacity from 60,000, by adding an additional tissue mill, to reach 120,000 tons, hence catering for around 40% of the tissue market.

Updates on TM6 include a signed contract with the machine supplier which was recently announced. Production is anticipated to begin in Q4 2026, further bolstering MEPCO's presence in the tissue market. The beauty of the tissue market product pricing is that it's directly linked to the cost of imported virgin pulp. The two indices that we follow include hardwood and softwood. We have seen a growth in both since Q3 2024. However, in the past quarter, they have decreased, indicating a minor market correction. Overall, 2024 is marked by steady recovery and growth in the pulp market, signalling a potential growth to balance after significant volatility.

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Looking at the exports and local sales review, it's important to mention that numbers here, beginning Q1 2024 onwards, include containerboard, tissue, and sale of other recyclables. When it comes to sales volume, export sales increased by 41% quarter on quarter, and 39% year on year. The value of this, however, has been higher, with 44% when it comes to value, both quarter on quarter, year on year. When it comes to local sales volume, it decreased by 14% quarter on quarter, and 15% year on year. However, the value was not as impacted as much, the value actually decreased less. It was 13% quarter on quarter, 14% year on year.

If we look at the sales distribution and value, we see that we ended Q3 2024 with 36% of our sales being exported, while 64% is local sales. This takes us back to previous years where we had similar ratios. It's important to note that the Red Sea shipping crisis has also raised shipping costs due to higher transportation costs.

Now for the Financial Review. Our sales revenue increased 9%, quarter on quarter. This is driven primarily due to an increase in quantity by 8%. Throughout the year, for the first nine months of the year, it increased by 21%, closing the year, as previously mentioned, 775 million revenue. This was also driven by higher quantity, especially taking into consideration the diversification efforts that we have, whether it's the tissue manufacturing plant or the sale of other recyclables when it comes to the trading aspect of things.

Gross profit decreased by 8% throughout the quarter, and increased by 66% throughout the year. This decrease throughout the quarter is attributed to an increase in price of raw materials. When it comes to the increase of 66%, it's due to diversification initiatives in addition to higher profitability margins through Juthur. To analyse the cost of sales, the cost of sales, as previously mentioned, increased by 13%, reaching SAR 227 million for Q3. If we look at the breakdown of the cost of sales, we can see that this is primarily attributed to a higher cost of fibre. Whereas variable costs remain the same, fixed costs actually decreased by 3%.

Cost of sales, year on year, increased by 14%, driven by the launch of Juthur operations, and as well as a higher quantity sold. The breakdown also shows a higher cost of fibre for the first nine months of 2024, by 3%. Other variables increased by 2%, and fixed cost decreased by 5%.

For EBITDA, compared to Q2 2024, we saw a drop of 57%. It's very important to note that this drop is primarily attributed to non-recurring expenses which happened during the quarter, more specifically due to a write-down of assets, which gave us an impairment loss of around SAR 16.7 million. So if we look at the adjusted EBITDA of this, it actually only decreased by 8% compared to the last quarter.

On the annual aspect of things, even including these non-recurring expenses, we see an increase of 19%, while maintaining the 8% EBITDA margin. If we compare last year versus the adjusted EBITDA, which means we're excluding the non-recurring expenses, it actually increased by 49%, year on year. And adjusted EBITDA margin for the nine-month period actually reached 10%, so the profitability aspect actually improved as well.

For net loss, it was reduced by 635%. Exactly for the same reasons as we mentioned previously, there is a non-recurring expense of 16.7 million, in addition to the higher cost of raw materials and shipping costs that impacted our profitability for the quarter. When it comes to year-on-year, we see that even with the non-recurring expenses, net loss actually improved from minus 50.2 to 33.8. It actually decreased by 33%. And profitability margins went from minus 8% to minus 4%. Again, this is including the non-recurring expenses.

The net profit breakdown quarter-on-quarter comparison. We mentioned revenue increased by 9%, primarily attributed by higher quantity of sales, 13% increase in cost of sales, primarily attributed by higher cost of raw materials. Our shipping and distribution expenses increased by 13% compared to last quarter, due to also higher exports, therefore higher shipping costs. G&A, there was a 4% increase. Our impairment losses was an increase of 447%, which includes the non-recurring expenses that we mentioned of the write-down of assets. And our other income increased by 19%, giving us a difference in net loss of 635%.

When it comes to year-on-year, revenue increased by 21%, driven by higher quantity and diversification efforts. Cost of sales increased by 14%. Shipping and distribution expenses increased by 7%. 24% increase in general and administrative expenses. This is due to higher overhead and administrative costs related to the launch of Juthur and to some additional consultancy costs. Impairment losses of 2,469%, majorly due to a write-down of assets in Q3. Other income increased by 27% due to an increase in finance income. And finally, the net loss that we experienced this year is 33% less than the net loss that we experienced last year.

Looking at the balance sheet ratios, working capital and working capital ratio increased by 298%. This is primarily driven by the proceeds of cash from PIF investment that was announced in Q1 2024. So we went from a 0.17 to a 0.69 ratio. Cash flow from operations decreased by 139%, reaching negative SAR 75.2 million. This is due to negative working capital changes, mainly driven by building up Juthur’s inventory stock. This includes increase in accounts receivable, as well as increase in inventory.

Our net equity decreased by 96%. It's important to note that following the recent capital injection, the company's net debt position has shifted from a net cash position, as cash and cash equivalents now exceed our outstanding debt, in addition to a decrease in long-term loans due to the repayments that MEPCO has undergone throughout the year. Our net debt to EBITDA decreased by 101% due to an increase in cash again. And it's also important to note that there has been also an increase in EBITDA, compared to December 2023, of 24%.

Our management outlook includes the top three strategies that we have. The first one is strengthening our vertical integration through the acquisition of a corrugator to enhance our vertical integration strategy, reach optimal production capacity for Juthur, expand sale of recyclables to others, secure materials for the latest containerboard machine announced, and diversify our product portfolio, which includes refining the product mix to cater to a wider range of customer needs and market segments.

Before we conclude, I'd like to reiterate my gratitude to everyone who contributes to our ongoing success, from our dedicated team to our valued stakeholders. Thank you for your time and attention today. We're now happy to take any questions you may have.

Nour Eldin Sherif Thank you, Hind, for the presentation. If you have a question, please raise your hand or submit your question in the Q&A box. We have our first question from Shouq. Please unmute yourself locally.

Shouq Alshahrani Hi, thank you so much. Shouq Alshahrani from Lazard from Lazard. I just have a few questions from my side. First, I want to know the breakdown in the revenue for this quarter between containerboard and tissue. It will be helpful to know because when I look at the big image, like when you talk about the volume growth and you talk about the price increase, it doesn't add up to the total growth in the top line, 21% total growth while you're talking about 40-plus growth in the year-over-year increase in the average price, and in the volume, single-digit growth. So I just want to understand what I'm missing here, when we're talking about the driver of the top line and what we're seeing in terms of the consolidated top line.

Unidentified Male Hi, Shouq. Can you hear me?

Shouq Alshahrani Yes, I can.

Unidentified Male Basically, we don't disclose our current revenues. We disclose them by cluster, and we look at them and manage them by cluster, manufacturing and the trading. What we can say is that basically for an overall increase, of course, because the pulp, the tissue production was not in place last year, the manufacturing would have a very high increase in terms of the quantities. But overall, if we want to speak about prices, the increase in containerboard is about a 5% increase in price. That is year-on-year from last year to this year. On average, it's about 5%, while the [inaudible 00:19:56] is about 10% to 11%.

Shouq Alshahrani Very clear. But because, previously, in the first and in the second quarter, you communicated how much it was, the revenue from the tissue, is that something that you're not going to be communicating going forward? Because it's helpful to see the breakdown so that we can track the margin movement.

Ahmed Fazary Look, Shouq, Ahmed Fazary, I'm the EVP of Commerce, so we can share with you some indications on the changes, quarter over quarter. If you're happy, I can share with you on the containerboard and paperboard and tissue, the progress. Let me take you through the changes that happened. Q over the same quarter previous year, volumes, basically the containerboard and paperboard have been more or less stable, with a 10%, increase in prices. On the tissue side of the business, the increase in volume is 54% increase, and 12% increase in prices. Comparing the third quarter over the previous quarter, containerboard and paperboard have increased in volumes by about 3%, and prices by about 2%. While looking at Juthor, or the tissue business, its volumes, Q3 compared to Q2, basically volumes and prices are more or less steady. If this.

Shouq Alshahrani It gives what I need, the information. Thank you so much. My second question is regarding the margin for this quarter. We saw the pick-up in the margin in Q2, I know that there is a seasonality impact, I think, in the sales mix, but even if I looked at it in year-over-year improvement, it's much less than what we saw in the first quarter. And if we looked at it q-over-q, it's, I would say, a noticeable drop. So what is the reason behind that?

Unidentified Male The main reason behind this is the increase in the raw material costs. Our raw material, mainly the OCC, which represents around 70% or 80% of our total raw material, prices have increased significantly in the last quarters.

Shouq Alshahrani You're not benefiting yet from the agreement for Jeddah municipality.

Unidentified Male We do, but we collect 450,000 tons. Jeddah cannot supply 450,000 tons. Jeddah would supply a maximum one third of this, so the key increase is not coming in the Jeddah area, it's mainly driven by other regions where we have significant competition, like Riyadh, Dammam, and larger cities.

Shouq Alshahrani And you don't see it easing, the cost? Going into now Q4, it's almost one month.

Ahmed Fazary Look, Shouq, generally fibre costs or recovered paper costs, generally speaking, globally fibre costs have been quite inflated. It's higher than what it normally should have been. And all markets are more or less interconnected, so whatever happens globally has also an impact internally. Not alone, of course what happens also in the domestic market, it has its own dynamics. So, going to Q4, actually we see maybe your question is more focused on the recovered fibres, but I can tell you that, looking at the recovered fibres and even the virgin fibres or the fresh fibres, we see a decline in prices going into Q4. We can confirm that.

Shouq Alshahrani Very helpful, thank you. I'll leave the floor for others to ask, then I'll come back in the queue. Thank you.

Nour Eldin Sherif Thank you. Our next question comes from Ahmed. Please, unmute yourself locally.

Ahmed Thank you, management, for the informative presentation. I would like to ask about the competitiveness initiative. We have seen several companies join this initiative launched by the government, and my understanding, there are some talks that government would be extending gas pipes to several factories, so is MEPCO entitled to join this programme, or are there any expected changes to the current facilities' heavy fuel oil dependence?

Unidentified Male As of now, we have not reached out for this programme. Hopefully, given the fact that we are a heavy fuel-dependent industry, we would be looking at this initiative with the government in the near future.

Ahmed Okay, but MEPCO can join this initiative, is entitled to this initiative as well, right?

Unidentified Male We have. We are currently assessing it. We are in the process. Actually, we are assessing it, and we have to work closely with the government to identify. This is still a new programme, and it's quite fresh, so we are in the process of assessing it. We hope that we could be part of it, given that we are a very heavy fuel-use industry.

Ahmed Okay, sure. And my second question is regarding the costs.

Unidentified Male Actually, sorry to interrupt you, but just before we entered into this meeting, our acting GP just approved adding us to the initiative.

Ahmed Okay, great. So this means that MEPCO's going to have a gas supply to the current facilities? And when is it expected to take effect?

Unidentified Male The expectation is 27, 28.

Ahmed Okay. And as of right now, how much energy costs represent out of the total cost of sales, if you can provide me with specific percentage or guidance?

Unidentified Male Let's say on a per-ton basis, it is around 130 currently.

Ahmed Okay, so it's close to 10%, 15%, correct?

Unidentified Male Almost, yes, up to 10%.

Ahmed Okay, clear, that's all from my end. Thank you.

Nour Eldin Sherif Thank you. As a reminder, if you have a question, please raise your hand or submit your question in the Q&A box. We will take the next question from the Q&A box. Is there any update on the M&A front?

Unidentified Male It's still work in process. And definitely would be happy to share once work in progress, and it's going through in a smooth manner so far. That's all we can share right now.

Nour Eldin Sherif Thank you. Our next question comes from Abdurrahman. Please, unmute yourself locally.

Abdurrahman Hi. Am I audible?

Nour Eldin Sherif Yes, we can hear you.

Abdurrahman Just a few questions for my end. Firstly, I just want to make sure I heard correctly, you just got the approval from the Ministry of Energy for the possible switch to natural gas away from HFO?

Unidentified Male Sorry, it was not clear, Abdurrahman, can you repeat, please?

Abdurrahman Yes. I just want to make sure I heard you correctly, you just got the from the Ministry of Energy to switch from HFO to natural gas the programme I mean.

Unidentified Male Yes, we got the approval to be added to the programme.

Abdurrahman That's great. And one other question from my end, are you still in talks with, I believe the regulator was, Mowan for the export of OCC?

Unidentified Male Yes, we are still in talks with the Mowan on the OCC, on the export of the raw material front.

Abdurrahman I see. That's very clear. And could you give us an update on the anti-dumping cases? I believe it was from Spain, if I'm not mistaken.

Ahmed Fazary There's no further updates. The previous anti-dumping case we have against Spain and Poland, it was valid for five years, and currently it expired and the market is open now, as per the standard custom duties applied on all imports. Just commenting on that, even though the case is not valid any longer, I believe at the time it provided a very clear message about how serious we take our market and how we accept the market to be an open market to competition. Yet, it has to be fair competition, and we will never spare an effort to go and raise any cases in case of any country trying to dump at the local market here. So I believe the message has been communicated quite well to the global.

Abdurrahman I see. So currently, you're not seeing any abnormal volumes coming in from any region?

Ahmed Fazary Nothing that would ignite filing a case.

Abdurrahman That's good. Thank you so much.

Nour Eldin Sherif Thank you. Our next question comes from Shouq . Please, unmute your set.

Shouq Alshahrani I wanted to ask about, you mentioned that you see an increase when it comes to raw materials, etc., but there has been an increase of inventory. So can I understand your rationale behind that? Why are you building up the inventory and these high prices while you are seeing it, I would say, easing or trending downward?

Unidentified Male No, the key here is, of course, this is not an OCC, and OCC, our inventories always remain the same because we got most of it from the local market. The key of building the inventory is in pulp, Shouq, because pulp has a long lead time. Now, again, you see the increase, there is a difference between in the price as well. So a ton of OCC would cost about $80 to $100, international market prices, a ton of pulp would cost about $700 to $800. So you can…

Ahmed Fazary you said 800 for OCC.

Unidentified Male $80 for ACC.So that difference, of course, when you translate it into reals and translate it into value, it's big. There is a long lead time for pulp, for virgin pulp, because it's not in the local market. That's why we have to build the stock. Otherwise, producing, unlike OCC, which you can collect from the local market.

Ahmed Fazary So basically, Shouq, it's the normal safety stock.

Shouq Alshahrani No, I got it. Very clear. I wanted to ask, when we look at Juthor now, does it now fully operational, or are you managing the operation there because of the energy costs, etc.?

Ahmed Fazary No, it's fully operational. Energy costs have been well in control in the previous months. So things are up and running. And it's a facility that's doing very well at the moment.

Shouq Alshahrani Okay. So when it comes to utilisation rate, has it reached the 80, 70 or not yet?

Ahmed Fazary Oh, definitely. No, forget about the 70. We’re above 80. We’re in the normal industry range. Maybe there are a few improvements that needs to be made, which are normal, to further increase the operating rates, but we're very close to 90%.

Shouq Alshahrani Very clear. Thank you so much. I want to ask also about the reason behind why you are increasing, I would say, your export, when we look at it on a Q-over-Q basis. Is it more attractive? Is it supporting the margin? When I look at it in parallel with the selling and distribution cost, I think this is the highest selling and distribution cost that I have seen in the last seven quarters., so I want to understand, is it going more to the export is costing you more when it comes to transportation, etc., or this cost increased because of the tissue, not because of the containerboard? If you can link it together.

Ahmed Fazary Let's look at the bigger picture first. Looking at year to date, our domestic sales volume is higher by 8%. So even with this drop in domestic sales volumes in Q3, year to date, it's 8% higher. Why did we increase our export sales in Q3? Basically, the freight rates have dropped for certain regions, nearby strategic markets that we sell to, and also selling prices have presented an opportunity to those export markets that we start pushing for the larger volumes that we missed out on the first two quarters of the year. And, yes, maybe you're looking at the selling and distribution, and commenting on the selling and distribution, you should see that also prices have increased, so prices compensate part of the selling and distribution. And part of the increase in selling and distribution is due to the general increase in costs of transportation. Even if you look at the local market with the increase in energy costs, transportation costs have increased. So I would look at it from all angles to try to give the right perspective.

Shouq Alshahrani Very clear. Thank you so much. It's really clear now. Just a question, also, the write-off that we saw this quarter on the PP&E, the 16 plus million, what is the reason behind it and why the happened now? I'm just curious about the timing.

Unidentified Male We have undertaken an exercise to update our fixed asset policy review and count all our current existing assets. And the exercise, in fact, started in Jan or Feb this year, but just finished in Q3. That's why. Now, whatever we have written off is mainly wear and tear of machinery. And the changes or the wear and tear of some equipment and parts that have been impaired during this period relates to all the maintenance that has taken place during the past 15 or 20 years in the company.

Shouq Alshahrani Okay, clear.

Unidentified Male But this is a one-time exercise that is done and closed and would not be incurred again, of course.

Shouq Alshahrani To be honest, I'm looking at the company profitability, I just saw some hope last quarter with turning to profit in the bottom line. Now, even if I remove the one-offs, still, you're going to be at losses of 2 million, and you said, since the beginning of the year, that we will see the market condition will be better toward the second half of the year, etc., so in terms of profitability, is it fair to assume that you're going to report, I would say, better profitability than Q2 towards the year end? I'm not asking for a specific number, just the direction when it comes to margin, based on the input that you have in terms of the selling price and cost, etc.

Ahmed Fazary Shouq, you're asking... It's a nice question, and we have limitations on what we can share. What I can share with you, which I believe should be helpful for you, what we can share is that we're very positive about our volumes looking into Q4. We are very positive about our fibre costs, the virgin fibre, the recovered fibres, which represent the highest percentage of our cost indication. While we are positive as well that prices are stable, we don't want to promise on the prices. But we promise that with the higher volumes, controlled costs, I believe that Q4 should be a positive quarter.

Shouq Alshahrani Thank you so much. I really appreciate it. Thanks. Thank you all.

Nour Eldin Sherif Thank you. Our next question comes from Abdurrahman. Please, unmute yourself locally. Okay, your hand is now lowered. Okay, so we'll have the next question from the Q&A box. Can you give us an update on the waste management?

Unidentified Male Yes. For the waste management, like we have shown in the presentation, we continue on increasing our sale of other material. We have reached the highest levels for probably for the past three or four-year history, that is the highest level of non-fibre material sales that has been reached during this quarter. We also continue on selling increasing the quantities collected of fibre and selling to others, mainly in order to prepare ourselves to our next machine, PM5, that would require an additional 500,000 tons to be collected in the Saudi region.

Nour Eldin Sherif That's clear. We have no further questions lined up, so I'll turn the call back to you for any concluding remarks.

Hind Kaddoura We remain focused on delivering strong results and creating value for all our stakeholders. Thank you for joining us today. I’m looking forward to hosting your next quarter. Thank you, everyone.

Nour Eldin Sherif Thank you so much. This concludes our call for today.