Company: **Pharos Holding**

Conference Title: **Oriental Weavers 2Q19 Results Call**

Moderator: **Radwa El-Swaify**

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Operator: Good day and welcome to the Oriental Weavers 2Q 19 Results call. Today's conference is being recorded. At this time, I would like to turn the conference over to Radwa El-Swaify, head of research at Pharos Holding. Please go ahead.

Radwa El-Swaify: Good day everyone. On behalf of Pharos Holding, we would like to welcome you all to Oriental Weavers second quarter 2019 results call. We are pleased to have with us today from the Oriental Weavers management team, Ms. Farida Khamis, VP of Corporate Finance, Mr. Jonathan Witt, President of OW, USA, Mr. Tamer Abd El-Aziz, Group CFO, Mr. Ahmed kamal, Business Development For Export Markets, Mr. Shehta Farouk, Group Financial Controller and Ms. Ingy Diwany, IR manager. Management will give us a short overview of results and then we will open the floor for questions. Now, I would like to hand over the call to Ms. Farida Khamis.

Farida Khamis: Thank you. Good morning and good afternoon everyone and welcome to Oriental Weavers quarterly investor conference call. Today, we will update you on the company's results for the second quarter of 2019 and provide updated guidance for the full year. In the second quarter, we delivered sales of 2.6 billion EGP, up 4% year on year. For the period, we recorded an EBITDA figure of 317 million EGP, 17% higher year on year equivalent to 12% of sales, mainly on lower material costs. This besides higher export proceeds and nonrecurring reverse free zone fees of 92 million EGP drove net earnings of 86% higher year on year reaching 214 million EGP. Ingy will take you through the updated guidance for the year.

Ingy Diwany: Thank you Farida. In light of the Egyptian pound appreciation and lower than expected demand in the local market, we reviewed our top line guidance lower to be in the range of 10.5 to

10.6 billion Egyptian pounds compared to 10.7 to 10.9 billion in our previous call. As for the EBITDA margin, we expect margins to be maintained at 11%. For the earnings after minority, we are expecting earnings to be between 580 to 600 million pounds. Now, we can open the floor for questions.

Operator: Thank you. If you would like to ask a question, please press star one on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach the equipment. Again, that is star one for questions. We'll pause just a moment. And we have a question from Nada Amin at EFG Hermes.

Nada Amin: Hello everyone and thank you for taking the time to have today's call. My question is mostly related to local demand. We've seen local demand across the consumer names be quite challenged over the second quarter. This was also evident in your results set, so I was wondering if you could please shed any lights on what the key sources of weakness in demand and if the company has any particular plans to try and remedy the situation? Thank you.

Ingy Diwany: Thank you Nada. Demand actually has been under pressure since the second quarter up till now. Demand was very weak during the holy month of Ramadan and also since the beginning of August given the feast. However, we expect local sales to recover in the fourth quarter given that Q4 last year, our numbers in the local market were down, especially due to the competition from Turkish products. However, as we introduce new collections this year, similar to the Turkish ones with more attractive and competitive pricing, we expect our local revenues to exhibit growth compared to fourth quarter of last year.

So on an annual basis, we reviewed lower our guidance for the local market to be within the range of 5% to 6% growth owing to the inflationary pressures that we see among consumers in the Egyptian market, especially in the mid-to-low end segment.

Nada Amin: Very helpful. Thank you.

Operator: And again, if you do have a question, please press star one. And at this time, there are no further questions. I'll turn the conference back over to management for any concluding remarks.

Radwa El-Swaify: Let me ask a question Ingy while we get more questions from our participants. Would you please give us some color on the pricing strategy for the rest of the year or the second half of 2019 in the local market? And would you also give us an overview about your export strategy and volumes in export markets? Where do you see volumes going?

Ingy Diwany: Yes, for the local market, we only implemented a minimal price increase in April on some items. However, as I've previously mentioned that given the elasticity of demand and the inflationary pressures that we saw in the past few quarters, Also, given the appreciation of the Egyptian pound and the lower raw material cost in EGP equivalent. So it's not likely that we are going to see any price increase in the local markets at least in the near term.

On the export front, I will leave Ahmed kamal to elaborate more on the export strategy and Jonathan will later give an update about the US market.

Ahmed kamal: As for export excluding the US market for now, our price point has been going down over the last three years. So given the increase we had in our capacity, we couldn't generate higher value for our exports. So going forward, due to competition on lower price points, we tend to focus on differentiated products -different qualities with better value, which means a higher price point.

So for the European market, for example, as well as the market in Saudi Arabia, which is one of the largest importer for the area rug, they are requesting more and more -- more development from medium to high end, which by end of the day can allow us within our capacity and expansion we have to grow a little bit going next year by 30 cent per square meter. This may reflect in our value of the export as well as, you know for the competition. So the medium-to-high end stores need to have their own qualities. So those types of stores -- because of the competition of the online, they need something different with a better value so the clients see a difference between what they see in online and what they see in the stores. Accordingly, we're working on this one.

So this will appear in the first and second quarter of next year because this is what we will introduce in our Domotex fair this year. So we are pushing for this level and we hope we will get a positive feedback by then.

Jonathan Witt: Yes, good morning. Obviously when you review the numbers as far as OW USA and our business in the Americas, we're very happy with the results of Q2, also for the first half of the year. Much of that success can really be obviously due to the situation with China and China has been a large supplier of area rugs to the US historically. We've been the beneficiary of some nice replacement programs with large retailers due to Egypt's lack of tariffs and really our capacity as Ahmed mentioned earlier and availability to really supply the large retailers and immediately take on some of these programs.

Also, the general marketplace has struggled a bit in the US. I'm sure many of you have heard some of our economic concerns, especially over the past couple of months. And retailers are looking for new ways to help drive business, to help bring store traffic, which is down for a lot of segments to bring customers into the stores and not just shopping online. So we have been the beneficiary there for some nice placements, as well as in this environment there have been a couple of importers who have gone out of business and or have reduced their ability to supply and retailers know OW in the marketplace and feel confident and our stability and our ability to supply them in a consistent manner. So we've been able to take some additional market share from that standpoint. So we feel very good about those first two quarters.

As we look at day to day, as I mentioned, orders that are coming in, retailers across the board, it's not a specific distribution channel or geography, are facing challenges and as we speak with them at a vendor meetings and/or at our trade shows, it's really hard for those executives to pinpoint exactly what is causing some of their challenges and especially, reduction in sales over the past couple of months. So we feel very good that we're taking market share and that we've been able to achieve the results thus far. Looking forward into the balance of this year, there are still some opportunities for replacement of Chinese programs. There were a few retailers who had substantial programs coming from China and instead of trying to replace those programs, which is a major undertaking for all involved, they tried to wait it out and see where this trade battle was going to end. But it's gone on much longer than expected and there's really, you know, no concrete plan of action.

So at this point they are beginning to look at replacement programs and we are in a very good position on those. So we feel like maybe the end of Q4 probably more into Q1 of 2020, we'll see some nice gains there. We also picked up a large program with Walmart in the fourth quarter, which will help drive some export to the US volume. And you know, the only other issue, if you look at our revenue value versus volume, there is our volume, as Ahmed mentioned, has been -- meters have gone up dramatically compared to revenue and a lot of that is pressure domestically to bring customers into the stores trying to react and have some lower price points. So we've seen really as a price per meter -- selling price per meter has gone down about 20%. So there's added costs for us and that additional handling to generate that value, that's probably our biggest challenge.

That's said, as Ahmed mentioned earlier, there is a differentiation need around the world. And a lot of that is driven by trends that we're seeing in the handmade side of the rug business. Not only due to the China situation, but in general, the countries who have primarily supplied handmade area rugs are facing labor challenges and finding skilled replacement labor to come in and know that craft and that art versus some of the opportunities that are available to the young folks in those countries as they've become more developed and technical. So there are a lot of retailers who traditionally have been more in the handmade and higher end price points who are now coming to us and looking for a better price points in machine-made, which helps us offset some of that degradation that we've seen in the meter price. And again, you know, going into the balance of the year, we still feel that we're going to be up in the 5% to 6% range in the US and all indications show that the industry as a whole is going to be lucky to breakeven in 2019 as we look at 2020, it's really a little early to try to speculate on where things will be just due to what's going on today in the market and then also as we enter an election year, which will be probably a little more turbulent than the US consumer is used to.

Ingy Diwany: Also, I'd like to mention that our exports to our top European customer, now up around 17% year on year in dollar terms, but on volume terms it's almost flat. So this indicates that the new product launches to IKEA have higher price points. So this is part of our strategy that we are focusing more on producing higher qualities with better pricing.

Operator: We do have another question from the audience. We'll go to A. J. Singh [inaudible] investment.

Speaker: Hi. I just have a few questions. So first of all, on the growth guidance that you've given and can you just try to break it down between domestic and international? Second is on the hotel segment. How do you look at this segment? What is the potential for you in Egypt for that segment? Third question is on the Saudi market. Is there a potential there in the corporate and the hotel segment given that we are seeing across EMENA region and not just in KSA increase in the hotels capacity. And then the last question on the dividend guidance.

Ingy Diwany: Okay. So for the top line, in the local market, we are expecting 5% growth in value terms. And on the export front, we are expecting almost flat export figures given the currency appreciation. For the hospitality in terms of numbers, so far in the first half of the year -- first half of 2019, our revenues in the hospitality in the local market were almost flat and this was due to a lower installations and lower activity. But in general Farida will give us the potential for the hospitality market in general, in Egypt and in the region.

Farida Khamis: Sure. Thank you. Well, basically in the Egypt, given most of the hotels have been refurbishing once again, because tourism has started to pick up. So within Cairo and outside in the Red Sea, and also with the new capital city in Cairo, we've seen a lot of new construction work, lots of governmental buildings, lots of new offices and we have a lot of contract work going on over there and not just with hotels, but generally even with the new expansion in MAC with artificial grass. There's a lot of potential in terms of the local market, in terms of wall-to-wall generally. And based on that, MAC is actually expanding its capacity both for the printed rug business and for the artificial turf. So we see a lot of potential in the local market, especially.

In terms of dividend guidance, we're looking at the same as last year. So we basically distributed 1.5 EGP last year and after dilution, that would stand around 1 EGP because we are having a two-for-one stock dividend expected early next year. So basically the 1.5 next year would be 1 pound, but we're looking at least at distributing the same amount as last year if not more.

Speaker: Great. Anything on the Saudi market specifically?

Speaker: Ahmed, would you like to –

Ahmed kamal: Yes. We see a challenge in the Saudi demand. What we are trying to do is to gain market share in spite of competition and the political situation. A Saudi competitor has been the major supplier controlling about the 70% of the Saudi market. We expect its share to decline in the near future. So we are pushing hard to gain market share in the Saudi Arabia market. However, we are exerting a lot of effort to develop what the Saudi market needs because it's a very special market with mostly wall-to-wall products. So we are just redeveloping our product to match Saudi Arabia taste. So it's a matter of trend and color but the situation is on our benefit. And we already doubled our figure in the first half of the year and we expect a little bit slow for the next half, but the overall figure for Saudi Arabia will be a double digit increase and next year there will be more chance for us.

So we confirm that the Saudi market is in a little bit challenging situation, but you know, we see opportunities for our product versus local competitors -even if it will decline by 30%- we still have the advantage to take over you know, the share of the competition.

Speaker: Thanks a lot. If I can ask one more question in terms of the capacity growth, what is the guidance there for 19 and probably the medium term if you can?

Ingy El Diwany: We add on average 2% to 3% to our production capacity annually.

Speaker: Great. Thanks a lot.

Operator: And at this time there are no further questions.

Speaker: Ingy, did you want to elaborate a bit about polypropylene prices and lower cost resulting from that?

Ingy Diwany: Yes, sure. So August prices are around $1,100, which is almost 15% lower compared to the average of 2018. Currently, we have stock of one month of polypropylene at an average price of around 1,150 and we are expecting prices to continue to go down a little bit. So the average for the year will be roughly around 1,130. As for the export subsidies, I will leave Tamer to elaborate on the backlog and the new expected program.

Tamer Abd El-Aziz: So far we have collected about 93 million Egyptian pounds in the first half of 2019 with a backlog of about 550 million up to the end of June. However, there is a new scheme that had been introduced by the government, where as the export subsidy will be in a form of cash and then cash incentives. This new scheme is expected to start from -- to be released by mid September, maybe early October with a back date from July. So far, the announcements and the discussions that this export incentive is going to be 40% cash and 60% in the form of non-cash. So far nothing concrete have come out and we're still waiting for outcome of how this will be managed and how our 550 million Egyptian pounds would be collected later on.

Farida Khamis: Thank you. If we have no more questions, we'd like to thank you for being on the call with us and we continue to be optimistic about our long-term prospects and although demand has started to slow in some of our markets, we're taking actions to improve our overall business performance with our dedicated staff, sizeable capacities and best positions in the marketplace. We continue to maintain our sustainable growth path. Thank you.

Operator: And that does conclude today's conference. Again, thank you for your participation.