Transcription for ORIENTAL WEAVERS

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Corporate Participants

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CI Capital

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Conference Call Participants

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Ahmed Moataz	*EFG Hermes*
Andi Dlamini	*GRS.*
Divye Arora	*Daman Investments*
Mohamed Hamza	*Cairo Holding*
Mohamed Zein	*Beltone Financial*
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Presentation

Operator
Ladies and gentlemen, welcome to Oriental Weavers First Quarter 2019 results conference call. I now hand over to your host, Khaled Sadek, analyst. Sir, please go ahead.

Khaled Sadek
Good day everyone. Thank you for joining Oriental Weavers Q1 2019 results conference call.

[Introductions]

I will now hand over the line to Farida to begin with an overview on the results and then we will open the floor for Q&A. Farida, the floor is yours, please go ahead.

Farida Khamis
Good morning, good afternoon everyone and welcome to Oriental Weaver's quarterly conference call. Today, we will update you on the company's results for the first quarter of 2019 and provide guidance for the full year.

In the first quarter, we delivered of EGP 2.6 billion, up 4% year-on-year. For the period, we recorded an EBITDA figure of EGP 257 million, [2%] lower year-on-year, equivalent to 9.9% of sales mainly due to intense competition, yet earnings came in 7% higher year-on-year reaching EGP 201 million as a result of higher interest income. Oriental Weavers continued to invest in product development to meet the ever-evolving demands of consumers with the addition of three state of the art weaving looms, [audio] machine in the first quarter of 2019.

[Audio] will take you through our updated guidance.

Ingy Diwany
We still maintain our top line guidance within the range of 10.7-EGP 10.9 billion, 4-5% year-on-year. As for the exports performance, we need to highlight the soft demand witnessed in some of our regions, however, we still maintain our guidance of 3-4% growth in exports in 2019.

As for the local market, we expect high single digit growth by yearend, and we witnessed reviving consumer demand in the showroom activities and on the wholesale level. There was a minimal price increase implemented in April.

For the EBITDA margin, we expect our EBITDA margin figure to be close to 11% and for the earnings, we expect a bottom line figure of around EGP 520 million and with a reversal of EGP 90 million that we expect to record in Q2, we expect bottom line to reach up in the range of 600 million.

Now, we can open the floor to questions.

Question and Answer Session

Operator
[Operator instructions]

We have a question from Andi Dlamini from GRS. Please go ahead.

Andi Dlamini
Can you kindly just elaborate on the intensive competition that you guys are seeing? Which markets are you seeing that in and can you just talk about what you expect from the China-U.S. trade war, just in terms of whether you expect any of that to be diverted to your direction or whether that could actually result in increased competition?

Farida Khamis
I will reply to your question on the European market level, and will leave Jonathan to elaborate on the U.S. level and the results of the trade war.

So far, our exports to Europe were down by around 18%, mainly because of our exports to the top European customer, which is IKEA, we witnessed a decline in shipments because of the slowdown witnessed in some of IKEA's international showrooms. According to the business development team of IKEA, shipments are expected to pick up again in the second half of the year. This is for the European market in general.

Jonathan, would you like to elaborate further on the performance of the U.S. market?

Jonathan Witt
With regard to the China-U.S. trade and tariff situation, rugs were riding at a 10% tariff for the past few months and, obviously, the threat was there for 25% and last week that was made official. Through, really, Q4 and the beginning of Q1, we did have some increased placements due to the 10% tariff. Other retailers with large programmes were waiting to see how everything would play out, because the 10% can somewhat be absorbed between a retailer's margin, unfortunately, a manufacturer's margin, so they weren't as motivated to completely switch programmes from China to other countries. That said, we have already felt and heard from some retailers who are looking now to move programmes because the 25% will ultimately be passed along to the consumer, and they are very concerned about that and its effect on demand. We do expect, as long as this 25% holds, to really see some increase in placements which could come into the Q4 time period in terms of sales for us.

That said, the Turkish devaluation against the dollar has brought a very competitive to the U.S. market, especially with some of the larger discount chains who don't have programme goods but take advantage of opportunity buys, direct container business. They have been able to get unbelievable prices and qualities out of Turkey at the present time. We will see how long those manufacturers can sustain that as that devaluation continues. But for the first four months of the year, it has been a very competitive situation on that front with the Turkish.

That said, we had a great Q1 with our value up 16% and our volume up 28%. That difference does indicate we are having to be more competitive and sell at lower prices, as far as our average metre in sales, but we continue to grow and we're taking market share, whether that is from Chinese programmes and also with the largest retailers who are looking for sustainable partners, a lot of the smaller factories coming out of Turkey may have great prices for a one-time deal, but they can't support nationwide programmes, so we have been getting the benefit of that over the past few months.

Operator
We have a question from Divye Arora from Daman Investments. Please go ahead.

Divye Arora
Just a question on – when you were talking about that 90 million reversal, what exactly is that?

The second question is linked to the export rebates, how much have you collected until the end of first quarter and how much do you expect to collect this year in total?

Any clarity on the rollback of the free zone fees of 120 million? Thank you.

Madani Hozaien
The amount we expect to reverse in Q2 is almost EGP 90 million. This represents the difference in free zone fees between the amounts we used to accrue according to the new investment law and the previous law. The company is not eligible for these higher fees of the new law and we filed a legal case, that is why we are going to reverse it.

Ingy El Diwany

The amount reversed will be 90 million and not 120 million as we previously mentioned.

Divye Arora
So that legal case is over right now?

Madani Hozaien
Yes, it is over and the declaration from the Ministry of Investments extends to all companies.

Divye Arora
So you will have a one-off profit impact of 90 million, but then going forward, this should also be impacting your future profits, right, because…

Madani Hozaien
This will impact the gross profit.

Divye Arora
From which years, this is from 2017 and 2018?

Ingy El Diwany
From June 2017 until December 2018.

As for the export subsidies, the second part of your question, we collected so far 76 million until end of April and the new programme will be launched on 1st July and all the backlog will be settled according to the previous export subsidy programme. According to the new programme, the Government will allocate EGP 6 billion for export incentives, 40% will be cash settlement and 60% will be non-cash settlement. Still, we do not have the framework for the non-cash part, so we expect to collect around 120 million during the year.

Divye Arora
So 120 million is the cash that you expect to collect?

Ingy El Diwany
It is still not clear how the Government will treat the non-cash portion, so we can maintain the guidance as the previous year, around 120 million.

Divye Arora
Can I ask you one more question regarding the margin side? So the margin guidance has been revised from around 12% EBITDA margin to 11%, so this is mainly linked to the discounts that you are offering? What is the cost increase you are facing, let's say, in the SG&A and the wages?

Farida Khamis
Exactly. For the SG&A, the figure in Q1 was maintained as the same quarter last year. For the wage growth, we increased wages by around 15% year-on-year, and this is expected to be offset by the lower raw material prices and the lower fees for the free zone.

Divye Arora
But the problem is that if the wages continue to grow by 15%, let's say, 10% every year and given the tough competitive environment, you won't be able to increase the prices of the end product by that much. Do we expect this margin squeeze to continue over the next couple of years?

Farida Khamis
For the wage increase, I would like to highlight that the increase was mainly implemented on the lower income staff, which are mainly the workers and we have a system for the remuneration increase that wages earned by workers are subject to the highest increase and as you go up on the management hierarchy, the increase is less. Free zone fees according to the previous investment law will be 60 million less than the amount accrued in 2018. This in our view is going to be offset the wage increase and the price adjustments due to intense competition. Polypropylene prices are still 12% lower compared to last year, so still raw material prices are lower and with the impact of the lower fees, and according to this, we still maintain our guidance of 11%.

Divye Arora
But the raw material prices are going up now; they have almost hit 1,200 levels for polypropylene recently.

Farida Khamis
Polypropylene prices for May are around 1,200 compared to last year of 1,330.

Divye Arora
There is a follow-up on the wage thing we were discussing, so this year is clear that the wage growth will be offset by the lower raw material prices and also the – because you won't be paying the free zone fees. My question was going forward, let's say, next years, 2020/2021, if the wage growth continues, or the cost growth, in general, in Egypt continues to be around 8-10% and the competition is stiff with the Turkey – the global economy is in sync right now and the competition is stiff, the depreciation and [inaudible] of the Turkish lira. It doesn't seem like that you will be able to pass on the higher cost in terms of higher prices of the product. Do you expect the margins to be lower continuously, let's say, if this year is 11, then maybe next year is around 10.5 and then it goes further down to 10 because of the cost increase and low price increases.

Madani Hozaien
I think that the solution for us, the strategic solution is to increase the market share and this is what we are doing. We are working on increasing market share, so increasing sales will offset all these costs.

Divye Arora
How will you increase your market share when the competition is much more – can actually lower their prices and you cannot, because the pound is appreciating the Turkish lira is depreciating, how will you be gaining market share in this environment?

Madani Hozaien
We offered some discounts and these discounts will help to increase market share.

Divye Arora
Do you think you have to discount much more versus what you are doing right now?

Madani Hozaien
We don't see it right now, but as far as the market allows these prices, we do not give discounts. We give discounts when we see opportunity that can be lost.

Farida Khamis
Also, given that the U.S. market is doing really well and, again, Jonathan can elaborate on that, we are expecting the U.S. market sales to increase and the U.S. is one of our largest markets, as you all know. Basically, with the tariffs imposed on the Chinese imports to the U.S., we are expecting our market share in the U.S., especially, to be positively influenced by this.

Divye Arora
What sort of a discount are you giving, like around 9-10%, in that range?

Madani Hozaien
It never reached more than 3%, if needed.

Operator
Khaled Sadek, do you have any questions?

Khaled Sadek
I have one, I am not sure if it is too early, but do you have some sort of guidance on expected dividends for this year for 2019?

Farida Khamis
We are expecting to have the same as last year and the year before, basically. Obviously, depending on any major changes in results or in CapEx, but the intention is to distribute the same as last year.

Khaled Sadek
One follow-up on the export rebate as well, is there some sort of Plan B if the rebate programme collection deteriorated significantly? Would you shift your strategy, be more focused on the local market versus export? Is that something that you would consider or business will continue as is, but just with lower cash collection?

Madani Hozaien
For the local market, we are already the market leader, so we will continue exporting. This is for sure.

Ingy EL Diwany
And also the export subsidy is not included in our pricing for the customers, so it is something extra that we receive and we even record it below the EBIT line.

Operator
[No further questions]

Farida Khamis
Thank you very much for your interest in Oriental Weavers and please feel free to contact us if you have any further questions at any stage. Thank you.