Transcription

Oriental Weavers, 13/11/2019 EV00097477

Wednesday, November 13, 2019

Presentation

Operator

Welcome to Oriental Weavers Third Quarter 2019 Earnings call. I will now hand over the call to your host, Ms. Alaa Tolba.

Alaa Tolba

Hello everyone. This is Alaa Tolba from CI Capital. I would like to welcome you all to Oriental Weavers Third Quarter 2019 results conference call. Joining us from Oriental Weavers, Ms. Farida Khamis, VP of Corporate Finance, Mr. Jonathan Witt, President of Oriental Weavers USA, Mr. Hani Amin, the General Export Director, and Ms. Ingy Diwany, IR Manager.

I am now going to hand over the call to Ms. Farida to begin with the company's presentation, which will be followed by a Q&A session.

Farida Khamis

Thank you.

Hello everyone and welcome to Oriental Weavers Quarterly Investor conference call. Today, we will update you on the company's results for the third quarter of 2019 and provide an updated guidance for the full year.

In the third quarter, we delivered sales of EGP 2.3 billion, down 9% year-on-year. This came mostly due to 14% lower export sales on EGP appreciation, lower sales mix, and uncertainty in the U.S. market on the woven side during the quarter, with some agents delaying their orders. Now, export orders from key U.S. clients resumed the normal pattern in Q4 with several new programs awarded during the quarter, with shipments to begin shortly, which will be reflected in positive figures next year

In spite of the lower raw material costs, our EBITDA margin remained almost constant at 11% during the quarter on higher expenses related to new showroom expansions. We collected export rebates of almost EGP 34 million during the quarter, a total of EGP 140 million in nine months 2019. This, besides the FX gain of EGP 28 million, drove attributable net earnings up 25% year-on-year reaching EGP 120 million.

Ingy El Diwany now will provide an updated guidance for yearend.

Ingy Diwany

We lowered our top line guidance for the year to EGP 10.1 billion, mainly due to the foreign currency appreciation and lower than expected demand in the local market. Our EBITDA margin guidance remains the same at 11% and our net earnings after minority interest remains the same as previous guidance in the range of EGP 580-600 million.

Now, we can open the floor for questions.

Q&A

Operator

[Operator instructions]

The first question comes from Aly Elgamal from Azimut Please go ahead.

Aly Elgamal

Hi, sorry, I was a bit unclear on what you were saying about the shipments picking up later on, so there were orders put in and they are still not fulfilled. Thank you.

Jonathan Witt

Yes, I think the reference was made to some programs – that commitments were made and orders were placed in this Q4. However, those shipments will not arrive to the customers abroad until Q1 and that is when we will realize those sales. The program commitments were substantial and we feel very good about our first half results in 2020.

Operator

[Operator instructions]

The next question comes from Divye Arora from Daman Investments. Please go ahead.

Divye Arora

Hi, just to understand what happened to the export backlog, because recently we heard news that the Government has come out with a plan to clear the backlog, 50% will be cash and then the remaining would be [audio] taxes and then some of the rebates, but we have not seen any collection in the third quarter. You have around 585 million still pending. Can you give some color on that?

And how about the collections going forward? So you are entitled to get around, I think, 230-240 million every year, so are you collecting that or will there be a delay again?

Ingy El Diwany

So what we collected so far in Q3 is around EGP 47 million. This is part of the initiatives that the Government offered to settle the backlog, so there were five main initiatives. The first one was tax settlement, and we already settled EGP 10 million of taxes, which were supposed to be paid by one of our subsidiaries. And the second initiative is to settle 10% of the backlog until June 2020. Under this initiative, we collected 37 million so far. The third initiative is about expansion, so we have already submitted our expansion plan and the Government should settle part of the backlog through paying us this expansion, by paying 20% upfront and the remaining 80% over five years. The fourth initiative is by offering land plots, and we do not intend to get any new land plots. And the fifth initiative is only for small and mid-cap companies, and this does not apply to us.

Currently, the Government is settling the backlog. Still, the new program is not launched so far, we expect it to be launched in January, which will be applied retroactively on exports starting 1st July.

To answer your question that the backlog is not reduced, because as we export now, this accumulates over the backlog account. So I hope this answered your question.

Divye Arora

That is correct. You are generally entitled every year for a rebate of around 250 million, 240 million, and probably you are collecting round 170, so the backlog keeps on accumulating because of that…

Ingy El Diwany

Yes, definitely. This is because the Government so far is allocating EGP 6 billion for export incentives. The total dues on the Government reached EGP 26 billion, so you can imagine our share is less than 5% of the total dues on the Government.

Divye Arora

So what are you expecting? In the next five years, this 580 million should be clear, but the problem is that the backlog still keeps on accumulating, right, there will always be a backlog.

Ingy El Diwany

Yes, definitely. But we are still waiting for the new program that the Government has previously mentioned. The new program includes a cash component of 40% and a 60% non-cash component. So hopefully with the new program, the settlement will be faster.

Divye Arora

So the new program is for your annual number, right, which is 250-260 million, which you are entitled every year, so for that you think it is 40% cash and 60% other things. This is what the new program is. For the rebates which will…

Farida Khamis

For exports starting 1st July 2019.

Divye Arora

OK, and the plan to clear the previous backlog is what you told us, those four, five initiatives, so there are two things.

Ingy El Diwany

Yes, this is for the backlog of 585.

Divye Arora

Which you expect to clear in the next five years.

Ingy El Diwany

Yes.

Divye Arora

Can you give us some sense on the market, also, given what is happening in Egypt, why the volumes are weak and what are you seeing? One of your – internationally, Turkey is one of your biggest competitors and the Egyptian currency has appreciated this year by 11%, whereas the Turkish lira has declined by around 8-9%, so you are at a big disadvantage right now versus the Turkish players. Are you going to face the heat in terms of market share losses and then you have to give further discounts, because Turkey must be undercutting you further?

Ingy EL Diwany

Well, actually demand is still under pressure since the second quarter of the year, and especially on the wholesale side, so we are feeling the pressure on Grade C and our lower end segment, given the inflationary pressures that the low-end people suffer from.

So what we are doing now is that we are working on new programs for wholesale customers, to offer like exclusive designs with various qualities and different price points. So we are going to focus on the low-end segment, which we feel there is pressure and most of the demand comes from this segment.

Definitely, the traders who import the Turkish products, they are all panicking now after the EGP appreciation and they are offering discounts on their products, because they already got stock and they have to sell it, so that is why we are offering now new promotions and giving discounts in our stores, and also introducing new qualities with lower price range. So we hope by end of Q4 and first quarter next year this will recover, and will drive more demand for our products.

Also with our new showroom expansions, so far we opened 11 new showrooms in different areas of Egypt targeting, also, the low-end customers, and we hope with the new showroom launches, this will also drive demand higher.

We introduced recently our online platform to sell rugs in Egypt online and this segment, of course, is expected to be the growth driver in the coming periods.

Divye Arora

So when it comes to the pricing, Turkey competes with you in the lower end in Egypt.

Farida Khamis

It competes on the low and mid end.

Divye Arora

So you have launched some new products in those segments to reposition yourself, but these products are launched at the lower prices so that…

Farida Khamis

We offer competitive prices, so our prices are 5% lower compared to the Turkish ones with different ranges and different qualities and designs.

Divye Arora

Sorry, I am saying, will that lead to lower margins for you, because you have to launch 5%...

Ingy EL Diwany

Well, actually, with the EGP appreciation and given that our dollar cost is more than 50%, so currently polypropylene prices are lower and also with the EGP appreciation, so we have room to give discounts in the local market while keeping our margins almost flat.

Divye Arora

Got it, so you are getting benefit from the dollar and…

Farida Khamis

Exactly.

Divye Arora

The other thing is in the international market, obviously the competition will be much more sharper now from Turkey, because of the Turkish lira depreciation and Egyptian pound appreciation, so what is the strategy. And what are you seeing the trends in Europe, in the U.S. in terms of volumes and your market share has been eroded in those markets.

Hani Amin

Hi, regarding the international markets, we have been trying to be a little bit different with strategies in the last two years. Now, we have a little bit focus on approaching retailers in different markets directly. I am talking markets like Japan, markets like Europe, Latin America, and also India as well. India is emerging as a growing market and becoming more and more organized over the years. We have been able to increase the direct retailers we are dealing with in Australia, for example, in Japan, in India, in Europe as well and, of course, in Latin America. So this was one approach.

Another approach to compete, like you were saying, with Turkish manufacturers is that we have been working with… you know the market changes, there is a lot of rugs in the market and customers now are looking for more facilities, so we have been obtaining new credit facilities from different insurance companies we have been dealing with in the last year. Historically, we were dealing only with one or two companies for the credit insurance, and this is a tool that you must have now to compete in the global market. So right now, we are dealing with four or five different insurance companies that, actually, cover shipments to new markets that we were not there before, new customers, and this has been showing really good results in the last six, seven months by obtaining new markets and new segments in the market, and also new customers as well.

So these two specific approaches have been very successful with us and we have been seeing really good results, and the results you can see in gaining more market share, and also in gaining new markets as well. In the last year, we were able to go into markets like Vietnam, Philippines, Georgia, and other markets, in Latin America as well, and besides also a few African markets.

And when I say new markets, I am not saying just approaching the market, but actually having business there. So these are the two main approaches we have been trying to focus on recently to compete with the global competition.

Divye Arora

How about Europe itself? You were saying the weakness is mainly coming from Egypt right now, internationally you are doing fine.

Hani Amin

Internationally, of course we see the competition, but what I am saying is, internationally, we have more diversification that we can apply to the customers and the markets that we can maneuver with. For example, we have, as I said, we have different markets with different tastes, different demand, so what we have been doing is we are trying to offer the customers in the international markets more tools and more incentives to work with Oriental Weavers, that were not maybe as much as in the past.

One other thing is expansion in the technology, in the machines. We are now having new machines that produce different types of products that you can rarely find in a country like Turkey, and this has been really good with markets like in the Middle East and also in Europe as well. For example, we have one type of product that – it uses a lot of colors and it is a specific machine that you can use for an indoor and outdoor rug. This kind of machine, we have like three or four of them, has been running non-stop all the year (2019), and we have now programs planned and shipping dates going to August 2020, so really diversifying your range of products by giving something the Turks are not giving, has proven to be very successful so far.

Divye Arora

I just want to understand, you're giving a guidance of EBITDA margin of around 11% this year, and your top line is almost similar or even lower versus last year. Last year you made 10.3 billion in revenues and the EBITDA margin was around 10.8%, so this year you will do a lower top line and the margins are almost similar around 11%. So how come your earnings will be 580-600, because last year the net profit was 500. It should be the similar range, right?

Ingy El Diwany

As you remember in the second quarter, we had reversed free zone fees of around EGP 113 million. Besides, also, we have higher export rebate this year compared to last year and we have FX gain, so far, 120 million or 122 million resulting from the appreciation. These are all items below the line that are going to drive our earnings higher.

Divye Arora

The FX gain is coming from where exactly? This is from the inventory or this is from the balance sheet side?

Ingy El Diwany

This is coming from the cash and receivables we have in one of our subsidiaries in the free zone area, so all the subsidiaries in the free zone area are dollar-based. Their financial statements are denominated in dollars, so when you have cash in EGP and receivables in EGP, it always causes FX gain on their statements from the appreciation.

Divye Arora

The fees thing, which you were talking about, 120-130 million on the reversal, that is something which is going to be continuing.

Ingy El Diwany

No, this was a one-time item that we recorded in the second quarter of the year. It was only due to the change in the law. We used to accrue for a higher free zone fee, and this law was cancelled, so we reversed back the amount that we used to accrue for.

Divye Arora

You used to accrue this until which year, until 2018?

Ingy El Diwany
We used to accrue it starting July 2017 until the first quarter of 2019.

Divye Arora
So you accrued for around, close to one and a half years, this fee, and then you reversed it.

Ingy El Diwany
Yes, exactly.

Divye Arora
So this year, obviously, this will not come, next year sorry, this is only a one-off from those…?

Farida Khamis
Yes, but we are going to record lower free zone fees as compared to last year on the gross profit margin, given that we used to account for almost EGP 80 million every year for the new law that was cancelled, so this year the fees are going to be less.

Divye Arora
Can I ask you something, so what is the fee right now at the current level with the new fee structure?

Ingy El Diwany
It is going to be 1% on local and export value-added. It used to be 2% on local sales from the free zone areas, and 1% on export sales. This program was cancelled and now we are reverting back to the previous program which is 1% on local and export value-added and not sales, so the number is lower.

Divye Arora
This year it will be how much, close to, let's say, 50 million, 40 million for this year? If the revenues re at 10.8, what is the number?

Ingy El Diwany
This is only on the free zone level, so last year we recorded around 60 million in COGs, this year it is going to be around 40, so it is between 20-30 million lower.

Divye Arora
Lower and there is also a one-off that you have taken from the previous year, which is added back for the time…

Ingy El Diwany
Yes, it was added back in the second quarter.

Divye Arora
Anything on the dividends right now or it is too early to ask?

Farida Khamis
We mentioned in the previous call that the dividend is at least EGP 1.5 per share, similar to last year, at least 1.5.

Jonathan will give more color about the U.S. market.

Jonathan Witt

Yes, regarding the U.S. market, as we mentioned earlier, we have actually been the beneficiary of the trade agreements or lack thereof with China and picked up some nice market share in the beginning of this year. That said, there were several major retailers in the U.S. who were a little more conservative about making those changes with what had been proven retail programs for them. Over the past few months, as it has become more evident that there is no foreseeable end to the trade war with China, we have been approached by those retailers to offer new replacement programs, which as mentioned, we feel like we have already received commitments on some of those and there are a few more in process, so we feel Q1 and Q2 of 2020 should be very strong and we will pick up additional market share.

In the U.S., we face some of the competition from Turkey, just like we see around the rest of the globe. That said, over the past two months, the instability in Turkey and the relationship between the U.S. and Turkey has started to create some question marks with some of the larger retailers in the United States as they have just suffered replacing products from China and the cost and expense of that and they are very concerned about crossing that again with Turkish products. Potentially, we see even more opportunity for 2020 as retailers look a little more deeply into their supply chain.

In general, as well, I should mention that analysts are projecting that the furniture, flooring, and home accessory sectors are going to finish flat or slightly below 2018, so when we consider that we're forecasting to be 4-5% ahead of 2018, that again shows where we are picking up market share as Oriental Weavers.

Divye Arora

Can you tell us more about the volume changes in the U.S. in the third quarter and nine months, volume and pricing?

Jonathan Witt

Yes, obviously the volumes have grown significantly larger than the growth that we have seen in value. That is driven by two factors. Over the past few years there has been a trend as technology – that Hani mentioned earlier – has improved, you can make such a great quality product with perceived value at a lower price, and with the dotcom (ecommerce) boom in the States, there has been some degradation in the average selling price. That trend is nothing new and it has been small over a period of time. This year, I would say the huge growth that you see in our volumes versus value is driven by that business that we were able to take from the Chinese manufacturers. Much of that was more entry price point product, so it has offset that lower average price per meter.

Divye Arora

How about Europe?

Hani Amin

Regarding Europe, we have been seeing like a lot of promotions recently coming from retailers. As I mentioned earlier, we are trying to have a strategy of targeting retailers directly, and some of these retailers are located in Europe. I am talking here, different types of retailers, DIYs, furniture retailers, supermarkets and so on. So we have been seeing, really, a big increase in revenues, I mean in export sales in markets like Germany, like Poland, like Sweden, Italy, Russia, and I would say also Romania as well. These markets are increasing in the section of woven rugs and the retailers, they are becoming more and more stable in the market.

We have been already with some of these retailers for many years, and others we just started business in the last one or two years. However, the opportunities are still big and we see a lot of opportunities coming in 2020 in more promotions, already secured one big promotion with a retailer that has 4,000 shops in Poland, 400,000 square meters, this was just signed last week and we are now in the pipeline of making six more promotions in Poland, Romania and Russia as well.

Also, we need to remember that our sales to IKEA… it is not like it used to be booming in the past, however, there is a new program that they call the Free Range Program, and free range program meaning that they are not committed to what IKEA usually runs for years. This is a new program where [inaudible] supplier to give them ideas that match with different markets that they are selling. For example, we have plans now for a free range program in the U.S. and the Middle East and these programs are actually in negotiations right now and expecting to materialize in the next two or three months, so hopefully by 2020, we will be having a share of these programs, I would say, not less than 50%.

Divye Arora
Just going back to the U.S., can we understand that the volume growth in the third quarter was quite weak? We only saw a 5% growth in U.S. volumes, this is for the woven business, and for the nine months it was 23%.

Jonathan Witt
I think there is a direct correlation there. Looking at the first nine months where we were up 4% in sales, 23% in volumes, and then obviously the third quarter, due to the timing of some shipments and, in general, some of the softer marketplace that we discussed, our sales in dollar terms were down 18% with volumes up 5%. So still close to the same range as far as the average price per meter that we're selling.

Divye Arora
So you think in the fourth quarter, probably… in the value terms for the nine months, you were up 4% in the U.S., for the nine months 2019 versus 2018. By end of this year, you should be closing flattish in the U.S.?

Jonathan Witt
We expect to maintain a 4-5% total 12-month over 2018 in dollar terms.

Conclusion

Farida Khamis
Thank you for joining the call and for your interest in Oriental Weavers.