Company: **EFG Hermes Holding**

Conference Title: **Oriental Weavers 4th Quarter 2018 Conference Call**

Moderator: **Nada Amin**

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Operator: Good day, and welcome to the Oriental Weavers' Fourth Quarter 2018 Results Conference call. Today's conference is being recorded. At this time, I'd like to turn the conference over to Nada Amin. Please go ahead.

Nada Amin: Hello everyone. This is Nada Amin from EFG's Consumer and Healthcare team. Thank you for taking the time to dial into today's call. On the line, we have:

- Ms Farida Khamis, VP of Corporate Finance;
- Mr Jonathan Witt, President of OW USA;
- Mr Madani Hozaien, the Group's CFO, as well as
- Ms Ingy El Diwany, the company's IR manager.

So, we'll turn the call over to them, and after a brief presentation, the company will be fielding some questions. Please go ahead.

Farida Khamis: Good morning and good afternoon. This is Farida Khamis. Welcome to Oriental Weavers' quarterly conference call. Today, we'll update you on the company's results for the fourth quarter of 2018 and provide updated guidance for the full year.

The year 2018 proved more difficult than we anticipated, yet we managed to navigate through it on the back of our diversified operations and efficient capital management. In the fourth quarter, we generated sales of EGP2.8 billion, plus 4% year-on-year. For the same period, our EBITDA was

EGP257 million, 27% lower year-on-year equivalent to 9.1% of sales. This came on the back of 13% higher average polypropylene prices reached $1,275 per ton, as well as wage inflation and high electricity tariffs.

In this environment, we selectively invested approximately EGP726 million in 2018, enhanced our long-term performance. Primarily we invested in 12 new weaving looms in our factories in Egypt and in the US besides yarn machines. This added 2% to our total production capacity. Going forward, we plan to continue investing in our weaving and yarn capacities.

We have added three looms during the first quarter 2019 with plans to add an additional three more looms, expanding the market demand among other investments with the total CAPEX in the range of €10 million.

The Board proposes a DPS of EGP1.5 and this should be approved on the AGM scheduled for 2nd April. And also, today we got the approval from the Financial Regulatory Authority to go ahead with the EGM to increase our paid-in capital through the distribution of a One- for-two stock dividend. As for the guidance for year-end, we expect to achieve or to record 4-5% sales growth reaching a range of EGP10.7 billion to EGP10.9 billion.

Now we can open the floor for questions.

Operator: Thank you. If you would like to ask your question, please signal by pressing star one on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, that is star one to ask a question. And we will pause for just a moment. And there are no questions at this time.

Nada Amin: Maybe I can get the ball rolling. I have two main questions, please. The first one is regarding the exports rebates. I know that the program has recently changed. Is there – are there any further details about what kind of compensation the company could receive? And my question is more on the margin outlook for 2019. If you could please provide some guidance for that.

Farida Khamis: Okay, for the export rebates, we collected so far EGP40 million in the first quarter of 2019 and we expect to collect between EGP150 million to EGP170 million before year-end. Currently a new program is being discussed and it should be released by July 1st. We have indications that this program will have a mix of cash and non-cash compensation for the subsidy.

As for the margins, given now that polypropylene prices are 12% lower compared to the average of last year, so the March prices were around $1,150 per ton. So, we expect prices to increase a little bit during the coming few quarters, given the maintenance shutdowns that are expected to occur in most of the polypropylene manufacturers across Europe and the GCC. So, prices this year are expected to be within the range of $1,200 to $1,250. Accordingly, we expect margins to improve a little bit compared to last year to reach 12%.

Nada Amin: Okay. Thank you. Operator, could we please – are there any other question?

Operator: We do have one question in the queue. Our question will come from Divye Arora of Daman Investments.

Divye Arora: Hi. I have a few questions. The first one is linked to the 120 million roll back of the fees. So, can we understand – I think this was linked to the 1% your[?] charge on the exports and 1% of the local. So, this 120 million is from 2017 and 2018 both or this is only linked to 2017? And the second question would be if it was 2018, also you paid this fee, then in 2019 this should impact your margins positively in addition to the 120 million one-off write-back. That's number one.

Number two, the margin guidance you are giving 12%, this is at what level, this is the EBITDA margin?

Ingy EL Diwany: Yes. Okay, do you have any further questions?

Divye Arora: Also, regarding the export rebate program. So, you were saying you expect to collect around 170 million. Generally, you should be receiving around 350 every year. So, can we expect that once this – the new program is released, then going forward you will start having an impact of 350 million, let's say, from 2020 itself?

Ingy El Diwany: Okay, the backlog for export rebates, currently it's around EGP490 million. We expect to collect between EGP150 million to EGP170 million in 2019. As for the free zone fees, I will leave Mr Madani to answer this question.

Madani Hozaien: The free zone fees, the differential is around 100 million, and once the court decision is approved, we will reverse that to the P&L of maybe first or second quarter this year. This is the differential of the two years, '17 and '18.

Divye Arora: Okay, so basically you are having 50 million per year?

Madani Hozaien: It's 19 months, seven months in 2017 and 12 months in '18.

Divye Arora: So, which would mean this should positively impact your margins?

Madani Hozaien: Yeah, to the bottom line of '19, yes.

Divye Arora: Yeah, so in '19, you will have a 70 million impact. That's a recurring impact going forward from '19 till the next few year – over the perpetuity, and then you will also have a one-off collection of 100 million?

Madani Hozaien: We will not accrue for it as we used to do yet.

Divye Arora: Okay. But still you have – still – okay, you will not accrue but I'm saying if you don't accrue, then there is a positive impact every year, right, of 60-70 million, whatever you are paying on the annual basis?

Madani Hozaien: Yes, around 60-70 million, yes.

Divye Arora: 60-70 million. That's fine. And the – and other question is linked to your polypropylene inventory. How many months of inventory you're holding right now and is there any plan to increase this inventory because the prices are low right now so you can actually – if your view is that the price is going to go up from the current level, then why not to hold around four to five months of inventory at this price?

Madani Hozaien: Actually we have one month inventory, and for the time being, March is not a low-price month.

Farida Khamis: You mean April?

Madani Hozaien: April, yeah.

Divye Arora: So, you were planning to be opportunistic if the price goes down further, you were saying you can have two, three months of inventory on your books?

Farida Khamis: We're studying now the possibility of warehousing to be able to do so. So, hopefully we can do so before the prices increase if they are set to. So, we're definitely studying that now.

Divye Arora: Okay, but what is your capacity, how much can you store? How much inventory can you store?

Farida Khamis: Currently just one month.

Divye Arora: Okay. So, you have to build more warehouses, you are saying, to store?

Farida Khamis: Exactly. So, we're studying – renting or building new warehouses. We're seeing if we can store in our suppliers' factory.

Divye Arora: Okay. In 2018, for the full year, what was the drop in the volumes in the local market?

Farida Khamis: The drop in the volumes for the local market; [inaudible] mainly after MAC, the tufted division, because of the change in policy, we focused in 2018 on selling medium to high qualities which came in with higher average selling price but lower volumes. So, that's why volumes declined mainly for the local markets.

Divye Arora: But what about the overall decline?

Ingy El Diwany: Yeah, in the woven – besides that, in the woven sector, in the second half of 2018, we felt the impact of the inflationary pressures on Egyptian consumers beside the slight penetration of Turkish products into the local market after the devaluation of Turkish lira.

Divye Arora: Okay, that's fine. Thank you.

Speaker: Thank you.

Farida Khamis: Thank you. As for our guidance for the local market in 2019, we are expecting 7% growth and this should come after two things. We had a 5% price increase in September of 2018, so this should reflect on the next nine months of the year besides volume growth, given the new showrooms that we are targeting to open. This year we are targeting to open between 10 to 12 showrooms in addition to the new projects of the new capital.

In terms of exports, we're expecting 3-4% higher export sales in 2019. And I will give the floor to Jonathan Witt, who is joining us from OW USA. We're expecting sales growth of 5-6% in the US backed by developments for Lowe's, Costco and Home Depot. And I'll let Jonathan elaborate further.

Jonathan Witt: Good morning. Yes, we've actually ended the year on a good up note at 13% up in value and 8% up in the volume. Looking ahead at 2019, we do see 5-6% over the course of the year. Our Q1 actually will end up in the 10-11% range due to some of the placements that Farida mentioned with some national retail chains that we'll see the effect of sales and volume for this time period. So, we're excited about that. I will say that our relationships with three of our largest customers have deepened. Those new placements should drive sales through the balance of the year. Our sales to the furniture stores, which is the second largest segment next to the national retail chains, continues to be strong, even though as an industry, the furniture segment has suffered the past, especially three months, the National retail Federation release numbers that their sales in January were down 2.7% versus last year January; and December they were down 1.4%. So, that considered that our business continues to outpace it, we're taking market share. So, we're very positive there.

And then in the US, of course, the e-commerce sector continues to grow. The double-digit growth for us year-over-year has been consistently – so, that is definitely the largest growing distribution channel.

The other side of things when you talk about the large discounters, over Q4 and into the beginning of Q1, we have faced some challenges due to the Turkish lira versus the dollar. The Turkish manufacturers have been able to offer some amazing deals on inventory that they had and/or raw materials that they can produce with. So, in the short-term, that has been a challenge. However, just released over the weekend where Turkey is in a recession for the first time in a decade and as these suppliers are now having to go out and buy new raw materials, we see that coming to an end. So, that's a real positive for our business.

Ingy El Diwany: Thank you. As for IKEA, we expect this year 7-8% growth in our exports to IKEA with 14% higher average selling price and 7% lower volume. In Q1 of 2019, the customer is currently testing the markets regarding the new launches, so we expect the orders to start in late March this year, end of month. Are there any further questions?

Operator: And as a reminder, that is star one to ask questions over the phones. And we do have a question from Noura Alagil from Aljaheer.

Noura Alagil: Yes, hi. Hello. I'm just wondering up on the warehouse you mentioned for the polypropylene. Can you please share with us the plant capacity for such if you are able to add that? Will you be able to store more than five months, let's say, of polypropylene inventories?

Ingy El Diwany: Okay, currently, the storage capacity that we have for the polypropylene is around 7,000 tons, which is equivalent to a one month's requirement. We are planning to rent or to establish our own warehouse with the same capacity of seven months.

Madani Hozaien: 7,000.

Ingy El Diwany: 7,000.

Noura Alagil: Okay. So, in addition of one month inventory?

Ingy El Diwany Exactly, yeah.

Noura Alagil: And can you share with us the capex you're expecting if you were to build this?

Ingy El Diwany: Yes, if we are going to rent, this is going to cost us around $4 per ton. If we are going to have an open warehouse, it should cost us around EGP4 million. If we are going to establish closed warehouse, it should go up to around EGP25-EGP30 million. So, the three options are currently being studied but there is another fourth option that we will store at the warehouses of the supplier. All options are currently being studied.

Noura Alagil: And you'd be paying rents on that?

Farida Khamis: Yes, of course. It depends on the negotiation.

Noura Alagil: Okay. Is it expected to be below the $4 per ton range?

Farida Khamis: Yeah, we are going to offer them the same amount renting outside and we will see.

Noura Alagil: Okay, and that's annual, right? And on the CapEx for 12 – the showrooms you're adding, 10 to 12, what's the capex for each store?

Ingy El Diwany: For the stores? Regarding the showrooms you mean?

Noura Alagil: Yes.

Ingy El Diwany: It's around EGP2,000 per square meter, and the average size of the showrooms that we rent is around 200 square meter. So, it's only the furnishing and the refurbishment, painting or installing tiles. So, it costs us between EGP2000 to EGP2500 per square meter.

Noura Alagil: Thank you.

Ingy El Diwany: Thanks.

Operator: And there are no further questions at the time. But as a reminder, that is star one. And we do have another question from Divye Arora.

Divye Arora: Hi. I have a follow-up question on the impairment side. So, what I've seen is that you have been speaking around on the average 90-95 million provisions in impairments. I think this is basically coming from receivables and the inventory. So, if you – I'm just taking the average of last four years. It's around 95 million. And in 2018, you took around 100 million. So, can we expect a similar number going forward?

Ingy El Diwany: Yes, around the same number, slightly higher between 100 million to 120 million.

Madani Hozaien: And part of the provision – is also a new law that took place in 2018 concerning the social healthcare. We book it as provisions this time not as part of COGS as we – for our free zone companies, we think that we are not eligible for it. We are not eligible, so we will go to court again.

Divye Arora: Okay. And you were saying that the rollback of this free zone fees, where were you booking this fees? This was the part of SG&A?

Madani Hozaien: it was recorded previously In the COGS and we will discuss with the auditor where to record the reversed amount, but most probably below the EBIT line.

Divye Arora: Okay. Thank you.

Madani Hozaien: Welcome.

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

Farida Khamis: Thank you.

Nada Amin: Thank you everyone for taking the time to dial into this call and have a good day.

Madani Hozaien: Thank you.

Farida Khamis: Thank you.

Operator: And ladies and gentlemen, that does conclude today's conference. We thank you for your participation. You may now disconnect.