Transcription for ORIENTAL WEAVERS

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Corporate Participants

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CI Capital

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Madani Hozaien
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Conference Call Participants

Ahmed Mansi	*HC Securities and Invetsments*
Richard Ladbrook	*Investec Asset Management*
Mohamed Zain	*Renaissance Capital*
Hadi Medhat	*Tharos*
Maral Sivzattian	*Samena Capital*
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Natalia Logevsky	*CI capital*
Hassan Badreddin	*NAEEM Investment holding*
Ahmed Mansour	*CI capital*
Aatman Ajmera	*East Capital*
Mrs. Shamy	*Arab African Investment Management*

Presentation

Operator
Ladies and gentlemen, welcome to Oriental Weavers Third Quarter 2017 Results Conference Call. I will now hand over to your host, Mr Khaled Sadek. Sir, please go ahead.

Khaled Sadek

Good day everyone. Thank you for joining Oriental Weavers 3Q17 results conference call. I would like to welcome with us on the call today from Oriental Weavers' management, Farida Khamis, VP of Corporate Finance, Jonathan Witt, President of Oriental Weavers USA, Madani Hozaien, Group CFO, Radwa Kamel, Group Treasurer, and Ingy Dewani. I will now hand over the line to Farida who will begin with an overview of the results and then we will open the floor for Q&A.

Farida Khamis

I would like to add we have Hany Amin Export Director online too, he was a new addition and not listed. My apologies.

Good morning and good afternoon everyone and thank you for your interest in Oriental Weavers and welcome to our quarterly call. We will be providing an update on our third quarter 2017 results and provide guidance for year end.

In the third quarter Oriental Weavers developed record export revenues, growing at 8% year-on-year in U.S. dollar terms compared to the same period a year ago, driven in large part by strong sales volumes in the woven and tufted segment. This is due to our continuous expansion strategy of opening new markets, while we expand our foothold in available markets. This along with our strong presence in the local market helped us to manage the slow performing local demand.

We would like to note that this quarter, reported comparable figures including the full nine months 2016 results of Oriental Weavers Textile, which was merged in September 2016. Our results will show that our profitability margins were under pressure this quarter , and this was due to a number of factors, firstly, inflation in raw material cost, average PP prices in nine months 2017 increased by 13%. Secondly, 48% higher electricity tariffs, resulting from the gradual phasing out of energy subsidies in Egypt. And also growing exports to our relatively lower margin European customers. Finally, expense fees totalling EGP 28.6 million applied to production from the free zone areas, in the third quarter compared to EGP 8.8 million in nine months 2016.

To satisfy the global market demand and remain as an industry leader, we received eight state of the art weaving looms in Egypt this year, and an additional two looms to be installed before year-end, and our CapEx is estimated to be €17 million by this year's end including some construction costs.

In terms of treasury and Radwa will elaborate somewhat later, we have settled our EGP debt to avoid the high financing charges, while maintaining a naturally hedged position on the balance sheet. Our debt obligations are currently 80% U.S. dollar denominated, and we expect 30% lower finance costs as a result.

Finally, for outlook, we maintain our guidance for yearend with net sales close to EGP 10.5 billion and earnings close to EGP 800 million before minority. For 2018, we expect 8-10% revenue growth under the assumption of a stable exchange rate, and we expect EBITDA margin to be approximately 15%. We expect earnings to grow 6-8% to EGP 870 million.

Thank you and we're open for Q&A, and [Zohni] and Jonathan will also be providing a summary of the export market and the U.S. market in particular through Jonathan. Thank you.

Hany Amin
Hi everyone, this is Hany Amin, I will present export department in Oriental Weavers and I will just try to give you a brief overview of the operations this year.

We have been witnessing two kinds of expansions in the export process so far, the first one is actually venturing into new markets like Farida mentioned, and the second expansion is actually increasing our market share in existing markets, in some particular and specific markets in different regions in the world.

So for the first expansion, we have been trying to add new markets in East Europe and in the Far East specifically, I am talking countries like Slovakia, like Georgia, like Ukraine, and also in the Far East, we are talking markets like Vietnam, Singapore, Bangladesh.

For the other expansion regarding increasing our market share in some stronghold markets, we have been witnessing a record year in Japan. This year, we are achieving, I think the highest turnover ever for Oriental Weavers in the Japanese market, and we have been increasing our sales in New Zealand and Australia as well. Also, we have been witnessing a big increase in some Eastern European countries like Poland and Czech Republic. Also, I believe we have been increasing our sales in Chile, in South America, we have been witnessing a very healthy growth rate in Chile as well this year, compared to the previous five years.

I think this is basically an overview of how we operate on exports and which markets we have been witnessing a healthy increase in the turnover so far.

I leave for Jonathan to speak a bit about the U.S. market.

Jonathan Witt
I am responsible for OW USA, our manufacturing and distribution in North America. Looking at the third quarter, it was an interesting climate in the United States, our revenue was actually down 3% for the quarter, some of that driven by the hurricanes that ravaged the southeasters United States and halted a lot of normal purchases. That said, once those homes are repaired, we should see a nice lift because there was so much damage in that region of the country, so hopefully at some point mid-2018, we will see very nice [audio] in those areas. In addition, there has been some uncertainty, I think, in the total marketplace. Furniture retailers are probably the largest distribution channel for rugs in the U.S. In general, their business has been flat, at best. That said, our business with furniture dealers is up 7%, so we have been taking a nice market share there, as well as the online ecommerce segment. The industry estimates are an increase of just over 10% in that distribution channel, but we are actually at 14%, so again another great area where we're picking up market share even through tough times.

Finally, a portion of the decrease that we experienced was just due to the timing of some of the large seasonal promotions around Black Friday, Thanksgiving and Christmas, where last year those were shipped from our warehouses in Q3, and this year, most retailers asked for those to be shipped in October. So when we look at sales year-to-date, now, we are back in the positive and have made up for that 3% decrease in Q3.

Overall, we feel like next year we should see an increase of around 5% for 2018, and will end this year up 2-3%. Thank you.

Question and Answer Session

Operator
[Operator instructions]

Our first question comes from Hadi Medhat, Tharos. Please go ahead.

Hadi Medhat
I just had a couple of questions, one of margins and one on prices. Margins declined in the quarter and so do you expect them to remain pressured going forward or are you expecting an improvement in margins. Also, prices in the export, like the woven export segment declined this quarter, should I expect more of the same going forward or do you plan to increase prices. That will be it.

Farida Khamis
On the margin level, we expect margins to improve in the fourth quarter driven by the strong export performance, because usually in the fourth quarter, it is the peak season for our export. So accordingly, this should drive the margins higher.

For the second question regarding the average selling price, we have seen a change in our mix and Zohni and Jonathan can elaborate more about it. There has been a change towards lower price points and I believe this trend will continue as well.

Hany Amin
Regarding the new product mix, we have been handling this especially in the last two quarters. We have been seeing a lot of promotions going out for entry level products that actually focus more on volumes more than the price points itself, so this has been a very common phenomenon from several retailers in the U.S. and in Europe and in Australia as well. Also, I think in the U.S. there has been a big increase in the outdoor products that has been sold and mostly the outdoor products are usually in the lower price point. This has been reflected on the average price for the export prices in general.

Jonathan Witt
In addition in the U.S. market, the online/ecommerce segment has driven volumes up in the double digits over the past couple of years, however, the average price point for rugs that are sold online and shipped directly to the consumer's home is less than our traditional average in a brick and mortar retailer. Again, while that can be a very profitable business, it does shift the mix down.

Farida Khamis
Regarding the second part of your question about the [audio], yes, polypropylene prices continue to rise. Currently they are around 1,180, so I

believe management is going to consider adjusting their selling prices in the export market and locally if the Egyptian pound is going to appreciate next year as expected, then raw material costs are going to be relatively low in Egyptian pounds.

Hadi Medhat
If polypropylene prices increase, there could be price adjustments, however, not in the local market if there is an appreciation.

Farida Khamis
In case of an appreciation in the local market, then there won't be – and polypropylene prices are higher, then it is less likely that we are going to adjust our selling prices lower in the local market.

Hadi Medhat
However you might adjust it in the export market.

Farida Khamis
Yes.

Operator
Our next question comes from Hassan Badreddin, NAEEM Investment Holding. Please go ahead.

Hassan Badreddin
I have two questions. The first one, why are you holding onto the exports business with higher than 50%, while its gross profit margins, its profitability margins is lower. The second question, what are the negative effects of the new investment [flow], and what is the strategy you will follow to avoid this.

Hany Amin
For the first question, why do we export, actually, it is one of our most – our strong position is that we are net exporters. We never rely on banks to satisfy or to fulfil our needs in foreign currency, so our foreign currency is fully generated from our revenue. This is why net export is favourable not the opposite.

Farida Khamis
We can add also to this that we have very strong relationship with international retailers and big boxes, which is an edge for us. I believe this is the top priority for the company in seeking foreign currency is through the export business.

Hany Amin
Actually, we were touched only in one point, which is for our free zone companies; we have sort of fees, 1-2% of our total revenue. Now, we are reorganising our production to have all our local sales through our local companies and exports will be mostly from the free zone companies to reduce the fees in the future.

Operator
Our next question comes from Aatman Ajmera, East Capital. Please go ahead.

Aatman Ajmera
I was wondering how many months of PPP [audio] between raw material prices going up and when it comes in the margin. Is it six months ahead? Is it already bought? I want to get a sense of that.

Farida Khamis
The lag is usually between two to three months.

Aatman Ajmera
I saw some provisions on your income statement that wasn't there last quarter. What is the provision related to?

Company Representative
It is related to the goodwill. We have management decision or agreed since long time to amortise the goodwill generated from the investments in some of our affiliates.

Aatman Ajmera
Which investment is this related to, the goodwill and amortisation?

Company Representative
This is mainly from [MAC], our [audio] division.

Farida Khamis
And there is EGP 10 million for tax…

Aatman Ajmera
My line was a bit weak when you mentioned your guidance for '17/'18, do you mind repeating that please.

Farida Khamis
We are expecting net sales of approximately EGP 10.5 billion, earnings close to 800 million before minority, 8-10% revenue growth assuming a stable exchange rate, EBITDA margin to be around 15%, and earnings growth 6-8% to be EGP 870 million next year.

Aatman Ajmera
I was wondering, most Egyptian consumer companies had a difficult first half with the oil decline volumes. In general, I am talking about food and the other industries, but you guys had it the other way around. You had a strong first half and third quarter was weak in terms of volumes. Was it a price increase in the third quarter that did this? I just want to understand dynamics in the local market?

Farida Khamis
No, there weren't any price increases in the third quarter. On the contrary, there were offers and promotions. The main reason for the drop in volumes in the third quarter is because you are comparing with a very strong quarter in 3Q 2016. This quarter was before the flotation and all the consumers were buying aggressively because of the expected flotation that took place later last year. This was the main reason for the decline. Also, we still see the market is very slow now.

We would like to add something to the Treasury policy.

Company Representative
On forward basis, our banks starting from April [audio] of $25 million, we expect to record 7 million out of it next year and… sorry, 7 million this quarter and next quarter, and 6 million next year. Next year will continue in

this hedging strategy, but on a lower volume. We don't speculate on the direction of the currency. We always try to maintain a naturally hedged position in any currency, so we are only selling [audio] in our foreign currency [audio].

There are no further questions

Khaled Sadek
Thank you everyone.
