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RAK Ceramics Q1 2022 Earnings Call and Webcast

Thursday, 12 May 2022

Mohamad Haidar Hello, everyone, and welcome to the RAK Ceramics first quarter 2022 earnings conference call. This is Mohamad Haidar from Arqaam Capital, and we are joined today by Mr Abdallah Massaad, group chief executive officer from RAK Ceramics, and Mr PK Chand, group chief financial officer from RAK Ceramics. Over to you, Mr Abdallah.

Abdallah Massaad Thank you, Mohamad, and good afternoon, everyone, welcome to RAK Ceramics first quarter 2022 earnings conference call and webcast, there I'll be taking you through our company's key business update and first quarter financial results.

I'm pleased to report that RAK Ceramics posted strong first quarter results, despite continued challenges including a spike in energy prices and trade challenges in addition to, most recently, the Russia-Ukraine war in February 2022.

In the first quarter 2022, performance was supported by key strategic initiatives, enabling the company to remain focused on driving further growth, strengthening profitability and improving the liquidity position.

We continue to solidify our positioning as a global provider of premium ceramics lifestyle solutions by increasing brand perception, introducing differentiated products and raising brand awareness.

From a sales standpoint, we were successfully able to increase selling prices to customers to partly offset increased incurred costs. We adopted a differential pricing approach catering to each end market, while maintaining a balance between market share and profitability, yet still to be in line with market practices.

From an operational perspective, we worked towards improving production efficiencies and capacity utilisation, optimising logistics costs and warehousing operations, installing energy-saving instruments and tightening collection policy to mitigate the impact of rising challenges.

In the first quarter 2022, also RAK Ceramics announced the signing of the sales purchase agreement for the 100% acquisition of Kludi Group, including 49% of the Kludi-RAK joint venture.

The acquisition is anticipated to complement RAK Ceramics' suite of products and grow its sanitary ware offering, enhancing, as such, RAK Ceramics' positioning in projects, and strengthening its status internationally as a fully-integrated lifestyle solution provider. We are currently working closely with the Kludi team to satisfy all closing conditions by 31st May 2022.

In numbers, total revenue for the fourth quarter 2022 increased by 8.3% year on year, and 4.1% quarter on quarter, to reach 783 million dirhams, driven by a strong growth trajectory across sanitary ware and tableware. Total gross profit margin for the fourth quarter 2022 improved by 2% year on year, reaching 37% despite the imposition of a 12% custom duty in Saudi Arabia.

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The increase in the GP margin was recorded mainly on the back of improvement in production efficiency, and production line optimisation across all our plants in UAE, India and Bangladesh. Our EBITDA stood at 129.7 million dirhams, compared to 126.1 million dirhams last year. Freight costs weighed in on margins, which decreased by 0.9% year on year, to reach 16.6%.

Our reported net profit stood at 69.7 million dirhams versus 62.7 million dirhams in the first quarter 2021, due to higher revenues and gross profit margin.

In the first quarter, also our net profit margin is 8.9%. Net profit after minority in the first quarter was 56.6 million dirhams, compared to 60.7 million dirhams last year.

Like-for-like net profit increased to 70.8 million dirhams, versus 63.5 million dirhams last year. Like-for-like net profit margin dropped slightly, year on year, to 9%.

Our net debt level remains stable, quarter on quarter, at 975 million dirhams, despite payment of dividends.

Moving on to more of a deeper view of our Q1 2022 strategic updates, the UAE market recorded resilient growth driven by an increase in brand exposure and a strengthened brand positioning, most notably through the launch of our e-commerce platform.

In Saudi Arabia, the company's strategy continued to yield results despite the imposition of a 12% custom duty. Quarter-on-quarter growth was recorded as RAK Ceramics focused on expanding its footprint and solidifying brand positioning as a premium provider in the Saudi market. In 2022, we are planning to grow further our retail presence in such markets by opening further showrooms.

The European market posted growth in the top line, however a surge in shipping freight weighed in on profitability. Despite increased transportation challenges, we continue to position ourselves as a trusted solution provider, aiming to extend the distribution network and tap into e-commerce.

In line with our strategy, we are looking forward to the opening of our London design hub showroom this month, which is expected to increase our customer base.

India's performance remained stable, year on year, supported by expanding the network presence in an additional 12 districts. Despite high energy prices, minor price adjustments were applied across the local ceramics industry, as per the guidance from relevant authorities. As such, we remain in line with peers and focused on preserving market share.

Bangladesh recorded a resilient top line, despite price adjustment. We anticipate further price increases in the second quarter 2022, as energy prices are expected to increase for local production following news about the rationalisation of gas supply in Bangladesh. We continue to closely monitor the situation and remain in contact with the local authorities, ensuring no disruption in business and preservation of market share.

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The tableware business posted robust growth across the core market, and profitability improved as production was increased to meet demand. The fourth quarter 2022 featured the introduction of our new tableware segment, bone china, an increasingly popular range of production for the horeca business. Further projects are scheduled to be launched in 2022.

In order to develop further our faucet business, we announced in March this year the signing of the share purchase agreement of 100% acquisition of the Kludi Group. This is a key milestone to our business, as it presents the opportunity for our company to spearhead expansion and strengthen its core business across European markets.

Kludi is anticipated to complement our suite of products, enhancing RAK Ceramics' position globally as a fully-integrated lifestyle solution provider. We aim to support Kludi to expand from a European-focused player to a global, innovative fittings manufacturer, while still preserving its name and identity.

Concerning recent economic developments, global manufacturing players continued to face challenges, weighing in on input cost and profitability, moreover, in some instances affecting the course of business. RAK Ceramics was able to withstand the rising challenges, as well as record growth in top line and an increase in profitability.

Surge in inflation, energy price hikes, and freight cost increases are mainly the key challenges our business is facing, not to mention the impact of the most recent event between Russia and Ukraine. We remain focused on identifying rising risk, and to actively work towards mitigating the impact and possibly creating opportunities from such risk.

I will now hand over the PK Chand, our CFO. Please, PK?

PK Chand Thank you, Abdallah, and good afternoon, everyone, and thank you for joining us. Abdallah has already briefly summarised operational highlights, regional performance and strategy update for the first quarter of this year. I will take you through the financial highlights with details on revenue, gross profit margin and the balance sheet.

We'll start from slide 13, financial highlights. Total revenue increased by 8.3% year on year, and 4.1% quarter on quarter, to reach 783.1 million dirhams. Tiles revenue remained stable year on year, at 516 million dirhams, supported by price increases to consumers to partly offset increased cost, while preserving market share.

Overall, tiles revenue remained stable despite a lower revenue, year on year, by 5.9% in the UAE and 24.4% in the Saudi Arabian markets. However, quarter-on-quarter tiles revenue increased by 5.3%. Sanitary ware increased by 13.1% year on year, to 155 million dirhams, supported by price increases.

Now, let me go through the market performance for total tiles and sanitary ware segments. In the UAE market, revenue was stable year on year, and grew by 6.3% quarter on quarter, to 164 million dirhams, supported by the wholesale and retail business.

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In Saudi Arabia, revenue got impacted by 24.2% year on year, due to lower sales in the wholesale business on account of implementation of the customs duty, effective 1st July 2021. However, quarter-on-quarter revenue increased 19.8% to 123 million dirhams.

India's performance has remained stable year on year, with revenue growth of 3.4% to 99.5 million dirhams, supported by minor price adjustments to offset the increased inputs and energy costs.

In Europe, revenue increased by 8.8% year on year, to 108.9 million dirhams, supported by increases in the selling price to partially offset the increased freight cost. The Bangladesh market recorded strong growth with a revenue increase of 13.9% year on year, to 85.5 million dirhams.

Tableware revenue decreased by 15.8% quarter on quarter, to 75.7 million dirhams, while still outperforming year-on-year levels by 84.3%, as the market situations across all our core markets have gradually improved. The total gross profit margin in the fourth quarter of 2022 increased by 200 basis points year on year, and by 340 basis points quarter on quarter, to 37.0%, despite higher input and logistic costs, and also the imposition of customs duty in Saudi Arabia.

The tiles margin increased by 210 basis points quarter on quarter, to 35.3%, while it is lower by 40 basis points year on year, due to the imposition of the Saudi customs duty.

The sanitary ware margin increased by 230 basis points year on year, to 38.6%, supported to an increase in productivity. The tableware margin improved by 18.6% year on year, to 48.8%, due to increased revenue and profitability. The reported net profit is 69.7 million in the fourth quarter of this year, compared to a net profit of 62.7 million dirhams in the last year. Margin is 8.9% in the first quarter compared to 8.7% last year.

EBITDA is 129.7 million dirhams compared to 126 million dirhams last year. Margin is lower by 90 basis points, at 16.6%, mainly due to higher freight costs. Net debt remained stable at 975.2 million dirhams on March 2022, compared to December 2021. Despite payments of dividends amounting to 112 million, supported by healthy working capital.

Net debt to EBITDA decreased from 1.94 times in December 2021 to 1.93 times in March 2022. In March 2021, net debt to EBITDA was 2.79 times. On the cash front, capital expenditure for the first quarter has been only 23.9 million. CAPEX for 2022 is expected to be in the range of 300 million to 350 million, excluding the cost of acquisition of the faucets business.

Now, we will turn onto the working capital cycle. In absolute terms, overall working capital decreased by 33 million dirhams, to 1.26 billion quarter on quarter, due to a decrease in trade receivables. In terms of days, it decreased from 175 days in December 21 to 167 days in March 2022, mainly due to the decrease in trade receivable days and inventory days.

Trade receivable days decreased from 94 days in the fourth quarter 2021 to 88 days ending the first quarter 2022, due to tightened collection policy. Inventory days decreased by two days quarter on quarter, at 215 days. Trade payable

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days remained stable quarter on quarter, at 62 days. We continue to take the necessary measures to manage our equity position.

The next slide shows the share price movement of RAK Ceramics, which has increased from 1.92 dirhams to 2.78 dirhams in the last 12 months, and trading at a multiple of 11.4 times on an LTM basis.

Now, we will turn to slide 19, where we can see that for our Bangladesh entity, listed on the Dhaka Stock Exchange, the share price has significantly improved from 30.9 takas to 37.6 takas per share, an increase of 54% in the last 12 months.

The current market capital of our Bangladesh entity is \$235 million, which contributes nearly 31% to the group market capitalisation, while the revenue contribution from the Bangladesh entity is around 11% to the group revenue.

RAK Ceramics paid a final dividend of 99.4 million, 10 fils per share in March 2022. The dividend policy has already been revised, which is to place a minimum dividend payout of 25 fils per share for the year 2022, to be paid on a semi-annual basis, and also provides for a commitment to pay a minimum dividend of 60 fils per share over the next three years, that is 2022 to 2024. Now, I will turn back to Mr Abdallah for his final comments before we answer your questions.

Abdallah Massaad Thank you, PK. Going forward, we aim to strengthen RAK Ceramics' position as being a fully-integrated lifestyle solution provider. We continue to align our priorities accordingly for 2022, focusing on protecting and growing our market share, expanding our production capabilities and differentiating our brand with the use of technology and in terms of offerings while operating efficiently and sustainably.

We prioritised our short-term initiatives, concentrating on finalising the Kludi acquisition as the first step to ensure a smooth on-boarding, in parallel, and in terms of operations, we are working to finalise the terms for production expansion and growing our offering to include further ranges of products.

From a tech aspect, we are working to further develop our e-commerce platform and to incorporate technological advancement into our processes and our offering. Finally, we are revisiting our internal ESG strategy, building necessary foundations to improve daily practices and allow the company to operate in a more sustainable manner.

As a closing remark, it is important to highlight that through the current challenges we have been actively monitoring and taking necessary action to mitigate rising risks. The future still remains uncertain and unstable, however the company remains adamant to navigate through challenges and emerge stronger by always thinking forward and being one step ahead. Thank you for your time. Now, I would like to hand over the call to the operator and open the line to questions.

Operator Thank you. As a reminder, if you would like to register a question, please press star followed by one on your telephone keypad. If you're dialling in online, you can register a question with the flag icon. So again,

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for any questions, that's star followed by one, or the flag icon if you're dialling in online. We've received a question from Sameer Kattiparambil of EFG Hermes. Sameer, please, go ahead.

Sameer Kattiparambil Thank you, Abdallah and PK for your presentation. I have a question on the Saudi market. I can see that it is the only market which is down year over year, and by a significant amount of 24%, could you give some colour on how the Saudi market is doing lately? Are they back to normal after the [unclear] slowdown led by the new building code?

And my second question is on the Bangladesh market, which embracing some topics of gas and electricity. So are you expecting any kind of operational disruption? And was there any gas price increase in Bangladesh last quarter?

Abdallah Massaad Thank you, Sameer. Let me start with the second one, Bangladesh. Until now, we did not get a gas price increase, but we are expecting that the government will increase the prices in the next half of this year. Regarding the disruption in gas and electricity, we did not have really disruption as of today.

Going back to the first question, Saudi Arabia, honestly, this first quarter, Sameer, it was difficult for us to find trucks, trailers, and the price of transportation costs increased, because suddenly also at the Saudi border there were changes from a FIFO basis, meaning any trailers come, they can get in on a FIFO basis to booking a slot.

A new system came in, and this create a lot of backlogs and a queue at the border. Whereas, fortunately, in March, this decision has been revised, and therefore I would say in March it was increased.

Going back to the market, the market is good, there is good demand. For us, it was the increase in custom duty by 12%, also we increased our prices, we opened our new showroom and we were trying to differentiate ourselves. I think in the second quarter it will be better, even though, as of volume, we are a bit cautious because we are working also on the margin and we need to maintain the margin we have.

Sameer Kattiparambil Thank you so much for that update. One follow-up question is on your Saudi expansion plan. We have been talking about it for quite a long time, any further update on that?

Abdallah Massaad Sameer, I agree with you it's a really long time, that's why we did not mention it. We are waiting. The land with gas allocation, unfortunately for the time, we did not get in any of the industrial zones, land with available connection for gas. So we have lined up several meetings with the authorities. Our plan is still there, we are only trying to get land allocation.

Sameer Kattiparambil And the last question from myself on your Kludi acquisition. Could you give me more colour on it? Its margin profile, how big is it in terms of the market share [unclear] in Europe? And what kind of valuation did you pay?

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Abdallah Massaad Sameer, Kludi was established in 1926, so it's a 100-year-old company, but we bought it from the family business, so it remained until now as a family business, so their focus is mainly Europe as a market. In 2006, in 2007, we had our joint venture with Kludi-RAK, established here in the UAE and we had a very successful business model from the top line and a very healthy bottom line.

Honestly, Kludi, we were talking to them for many years, and finally the owner, the family, decided to sell. And we are very excited with this acquisition, as it makes a lot of sense as RAK Ceramics, it complements the suite of business. We'll have a very clear business with four divisions, tiles, sanitary ware, tableware and the faucets business.

So the top line of this company is 120 million euros. In terms of margin, it's a very tiny margin, it's not a big margin, that's why we feel that we can add a lot of value and we can make a turnaround and make it a multinational by itself. So therefore the price which we paid, it was 19 million plus... So 39 million euros in total, as a company.

PK Chand And, Sameer, just to add to what Mr Abdallah said, the Kludi acquisition, since we already owned 51% of Kludi-RAK, we are not consolidating Kludi-RAK line by line in our current financials. Only the 51% profit of Kludi-RAK is getting accounted for in our books as equity invested. So to that extent, the profit of the full Kludi-RAK will come, as Mr Abdallah explained, the top line growth will come, which is about 120 million euros on a yearly basis.

Sameer Kattiparambil Understood. And thank you so much, and I thank you all the best.

Abdallah Massaad Thank you, Sameer.

Operator As a reminder, for any further questions, that's star followed by one on your telephone keypad, or the flag icon if you're dialling in online. We have a question from Albert Momdjian of Sokotra Capital. Albert, please, go ahead.

Albert Momdjian Thank you very much. Hi, Abdallah. Hi, PK. Thank you very much for the very good quarter. You're spoiling us as investors, so thank you very much. A follow-up question to PK on the issue of the consolidation. Can you clarify again what you just said on the consolidation of the acquisition, and what is the impact going to be exactly, in the following quarters?

And does this impact, by any chance, the overall leverage of the company or not? And how was this acquisition made? I've seen the 1.93 times net debt to EBITDA, do you expect this to continue to be at this level or to come down? That's the first question.

And the second question, the strategic one, is obviously turning the unfortunately events in Russia and Ukraine into an opportunity for RAK, any plans to be positioned for the reconstruction phase that people are estimating to be very significant, in the hundreds of billions of dollars, for RAK to be well-positioned should the situation stabilise or improve in the future?

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PK Chand If you want me to take the second...

Abdallah Massaad Thank you very much, by the way, and you are doing our job. As you say, when the war started, it really put pressure on use in terms of logistic costs and energy prices, as well as the raw materials. A lot of disruption happened, especially as Ukraine is an exporter of a ball clay which all of us use.

Fortunately for us, we have another formula which we're able to run without the Ukrainian ball clay. Now, even though we are paying a lot of high freight costs to all of Europe, because of the increase in gas as a disruption of raw materials, and while we are known as a serious, reliable supplier, we were able to pass on the prices to the market.

I agree with you now, we are all hearing about the reconstruction, but hopefully this starts by the end of the war. I believe that by that time everybody will be beneficial. For sure, we are positioned with our position globally, with the range we have, with the brand as well as the range we have, we hope, if the reconstruction starts, we will be part of it.

PK Chand Now, as for the consolidation of Kludi group is concerned, Mr Abdallah had mentioned that we are targeting 31st May as the closing date for the transaction. The Kludi Group, including Kludi-RAK, the turnover is around 120 million euros on a yearly basis. Currently, there is no consolidation line for line, so on a yearly basis the revenue of RAK Ceramics will definitely go up, around 120 million euros.

As far as the profitability is concerned, we already own 51% of Kludi-RAK, and if you see our financials, around 15 million dirhams is coming as a share of the profit in equity accounting [unclear] on a yearly basis. So the balance, 49%, will also come to our financials, and since the Kludi Europe, currently the profitability is either plus or minus side, it is not significant, so currently what is going to happen is that the balance, 49%, profitability of Kludi-RAK will get accounted for in our financials on a yearly basis.

The next question you asked is about the funding of the acquisitions. As Mr Abdallah mentioned, the funding cost is around 19 million euros, which is not significant. So we have funded it from our funds.

And then, there is an existing loan of about 21 million euros in Kludi Europe, so that also we will be taking over. To that extent, our net debt will increase, but profitability will also improve and we are working on various synergies, so all this will come into play.