Operator: Ladies and gentlemen, welcome to Rak Ceramics first Quarter of 2019 earnings call and webcast. I'll now hand you over to Mohamad Haidar from Arqaam Capital. Sir, please go ahead.

Mohamad Haidar: Good afternoon, ladies and gentlemen, and welcome to the Rak Ceramics first quarter 2019 earnings conference call, hosted by Arqaam Capital. This is Mohamad Haidar from Arqaam Capital Research, and I'm joined today by Mr. Abdallah Massad, Group CEO of Rak Ceramics, and PK Chand, Group CFO of Rak Ceramics. Without any delay, I will now hand over the call to Mr. Abdallah. Please go ahead.

Abdallah Massad: Thank you, Mohamad, and good evening, everyone. I'm Abdallah Massad, the Group CEO of Rak Ceramics. Welcome to Rak Ceramics first quarter 2019 results conference call and webcast, where I will take you through the key business updates and first quarter financial results.

Abdallah Massad: 2019 started also with the continued challenges. The liquidity in the GCC market continues to be tight. However, the increasing oil price will be supportive of higher government spending going forward. Despite these pressures, we continued to deliver satisfactory results through the implementation of our strategy, which including branding, specification, product differentiation, product efficiency, and focus in various markets.

Abdallah Massad: During the first quarter, our revenue remained low in tiles as January dispatches have been weak due to push sales in the last quarter of 2018. However, there has been growth in sanitaryware, tiles, tableware, and faucets business. Our total revenue decreased by 6.3% year-on-year to 620 million dirhams, due to decrease of 11.6% year-on-year in tile revenue, mainly in UAE, Saudi Arabia, Middle East, India, and Bangladesh markets.

Abdallah Massad: Sanitaryware revenue increased by 6.3% year-on-year, mainly driven by European markets. Tableware revenue increased by 15.1% year-on-year, driven by UAE, Europe, US, and Asia markets. Other non-core revenue decreased by 11.8% year-on-year to 30.9 million dirham, mainly due to a decrease in ceramics raw materials trading business.

Abdallah Massad: In the UAE market, our total revenue decrease by 9.3% year-on-year due to low dispatches during January 2019. Tile revenue was lower by 9.6% year-on-year and sanitaryware lower by 8.3% year-on-year.

Abdallah Massad: Revenue in Saudi Arabia is lower by 9.8%, compared to the first quarter in 2018. We faced issues for deliveries due to shortage of trailers. Tile revenue was lower by 11.2% year-on-year, and sanitaryware revenue increased by 3.4% year-on-year, compared to the first quarter of 2018. We are pleased to report that initiatives taken during last year for rationalization of manpower and warehouse costs has resulted in reduction in overheads and improved profitability in the Saudi Arabian entities. The merger of two Saudi entities is still in progress.

Abdallah Massad: We had announced during last call that we intend to invest in a state-of-the-art production facility in Saudi Arabia to manufacture tile with the approximate capacity of 10 million square meters per annum in the first phase. This will help to regain our market share in Saudi Arabia, as well as in the region.

Abdallah Massad: Discussion on land and gas allocation are under progress. We are optimistic for growth in Saudi Arabia due to increasing construction activities and the attractive cost advantage for manufacturing due to competitive energy costs. We expect that ongoing GCC-wide anti-dumping investigation on ceramic tiles import from China, India, and Spain would lead to improvement in prices.

Abdallah Massad: In India, commercial production of slabs in green field joint venture in Morbi, Gujarat has started, and development of product range in progress. The reported revenue in the first quarter 2019 is lower by 11.8% year-on-year to 75 million dirhams. However, it is higher by 1.4% QoQ. In local currency. Tile revenue was lower by 13.5%. In local currency, it is 5.2%, while in sanitaryware, revenue increased by 17.4%.

Abdallah Massad: The recent order for National Green Tribunal India to close the ceramic tiles and manufacturing units run on coal gasifiers is expected to have positive impact on Rak Ceramics India. Majority of unorganized ceramic tiles manufacturing in Morbi cannot switch over immediately from coal to natural gas due to high cost on investments in changing the burners and also, the production will increase the cost of energy costs. Our priority for 2019 is to ramp up full-fledged production at the recently acquired Morbi facility win projects order of scale from developers and production costs optimization.

Abdallah Massad: In Europe, revenue is higher by 10.8% year-on-year. Tiles revenue is lower by 0.9%, while sanitaryware is higher by 27.4% year-on-year. Last year, we had rationalized the warehouses, sales team, and supply chain management. We are further taking initiatives to increase sales and margins. The turnaround will be seen in 2019 as the new team and the structure stabilizes and move forward.

Abdallah Massad: In Bangladesh, competition is increasing due to the capacity built up. Reported revenue is lower by 6.8% year-on-year. Revenue in local currency is lower by 6.1% year-on-year. Tiles revenue in first quarter 2019 is lower by 9.9%, and sanitaryware is lower by 0.4% year-on-year. Gross profit margin improved in both tiles and sanitaryware. We continued focus on branding and pushing sales by providing incentive scheme to dealers. We have plans to optimize production to produce larger size and value-added products and maintain market leadership position.

Abdallah Massad: In Africa, revenue have improved by 10.7% year-on-year. In MENA, revenue for first quarter 2019 continued to be under pressure due to continued blockage of trade to Qatar. Going forward, the pressure might ease. In tableware, revenue growth in the first quarter 2019 is 15.1% year-on-year. The main growth drivers are UAE, Europe, USA, and Asia markets.

Abdallah Massad: We have been awarded in 2019 Red Dot Design Award for our HIDE Series. The warehouse and showroom in Luxembourg are expected to be completed by end of third quarter 2019. During another challenging quarter, we focused on improvements in operational efficiency, and these have enabled us to increase our total gross profit margin at 32.8%, which is 100 basis points, compared to the first quarter 2018.

Abdallah Massad: We are at a significant disadvantage, compared to our peers, as we pay higher gas prices. We would deliver higher income growth if gas price were competitive. As a strategy, that cost has been partially hedged by hedging the crude, effective April 2019.

Abdallah Massad: We keep on upgrading our machinery to lower cost of production and differentiate our product in the market. In the first quarter of 2019, SG&A costs decreased by 8 million dirham year-on-year, while net finance cost increased by 3.6 million due to forex losses for higher currency volatility, increased labor, and impact of 1.4 million towards reclassification of lease rent to finance costs as per IFRS 16.

Abdallah Massad: I will now take you through the main financial highlights for the first quarter. Total revenue decreased by 6.3% at 620 million dirhams, compared to the first quarter of 2018 due to decrease of 11.6% in tiles revenue. Total gross profit margin increased by 100 basis points at 32.8% year-on-year due to increase in tiles gross profit margin by 90 basis points, to 27.8% on improved efficiencies.

Abdallah Massad: Reported net profits stand at 36.9 million dirhams, lower by 43.6% year-on-year. Net profits in the first quarter 2018 included gain of 18.9 million dirhams on sale of contracting assets, excluding gain on sales, of such sales of assets in first quarter 2018. Net profits of the first quarter decreased by 20.7%, mainly due to lower tiles revenue.

Mainly due to lower revenue in the first quarter 2019 and extraordinary gain of 18.9 million on sale of contracting assets in the first quarter 2018, net profit after minority for first quarter 2019 decreased by 48.2% year-on-year to 29 million with margin decreased by 380 basis points year-on-year to 4.7%.

Abdallah Massad: Total EBITDA decreased by 9% to 97.9 million dirham year-on-year with margin decrease of 100 basis points to 15.8%. Like for Like net profits decrease of 23.5% to 38.1% with a margin decrease of 140 basis points to 6.1% year-on-year. Our net debt level increased from 1.43 billion dirham in December 2018 to 1.53 billion dirham in March 2019. Net debt to EBITDA increased from 3.23 to 3.54 on dividends payment of 135.2 million dirham.

Abdallah Massad: Thank you for listening. I will now hand over to PK Chand, our CFO, to brief you on the Q1 2019 financial highlights.

PK Chand: Thank you, Mr. Abdallah. Good evening, everyone, and thank you for joining us. Mr. Abdallah has already briefed summarized financial highlight, regional performance for the first quarter of 2019, and therefore, I will take you through segmental highlights with details on revenue, profitability, and balance sheet. Let us start with slide seven.

PK Chand: On total revenue, our total revenue is lower by 6.3% to 620 million dirham, compared to the first quarter 2018, mainly due to lower tiles revenue. Tiles revenue decreased by 11.6% year-on-year to 403 million dirhams due to a decrease in revenue from UAE, Saudi Arabia, Middle East, India, and Bangladesh markets. However, sanitaryware revenue increased by 6.3% year-on-year to 126 million dirhams, mainly driven by European market. Tableware revenue also increased by 15.1% year-on-year to 60 million dirhams, driven by UAE, Europe, US, and Asia markets. Other non-core revenue decreased by 11.8% year-on-year to 31 million dirhams, mainly due to decrease in ceramics raw material trading business.

PK Chand: Of the total revenue in the first quarter 2018, tiles contributed 65%; sanitaryware, 20%; and tableware, 10%; and non-core, 5%. Details of revenue by end markets have already been briefed by Mr. Abdallah, so I will skip slide eight and go to slide nine.

PK Chand: Total gross margin increased by 100 basis points year-on-year to 32.8%. Tiles margin increased by 90 basis points year-on-year to 27.8%, driven by continued improvement in operational efficiencies. Sanitaryware margins are stable at 39.9%, while tableware margins decreased by 8.4% year-on-year to 51.6% due to change in the product mix.

PK Chand: Next slide, 10, shows the summarized financial highlights with details of performance on operations. We have already briefed the same.

PK Chand: On the cash front, capital expenditure has been relatively high in the first quarter of 2019, compared to the first quarter of 2018 at 67 million dirhams. Major spending has been for Morbi JVs, amounting to 30 million dirhams and 29 million dirhams has been for UAE plant upgradations and maintenance. Capex for 2019 is expected to be in the range of 250 million dirhams, including maintenance capex of 125 million dirhams.

PK Chand: Now we turn on operating cycles, as given on slide 11. As far as quarter-on-quarter is concerned, there is a decrease in inventory days from 246 days to 244 days. Trade receivables also reduced from 108 days to 106 days, with increase in payable days from 74 days to 79 days. Overall, operating cycle reduced by nine days to 271 days quarter-on-quarter.

PK Chand: Now I would like to turn back to Mr. Abdallah for final comments before we answer your questions.

Abdallah Massad: Thank you, PK. Looking ahead for rest three quarters of 2019, there are a number of external macro factors which will continue to affect our business. However, we are focused on enhancing our brand and optimizing operation across the group while continue to protect our strong market share in the UAE, India, Bangladesh, and Saudi Arabia.

Abdallah Massad: We expect 2019 to continue to be challenging, but we will remain focused on our key priorities. These include to protect our growth in the UAE, India, Bangladesh, tableware business, we will continue investing in our branding and positioning with focus on media, digital marketing, revamping of our showroom and shop-in-shop concept, social media, visual merchandising, portal for B2B and B2C markets, brand and seasonal campaign and participation in exhibition, and maintain market leading position.

Abdallah Massad: In UAE, we continue to supply tiles and sanitaryware to premium developers like Emar, DAMAC Nshama , and also through corporate deals. As I previously mentioned, we anticipate a turnaround of India, which will be supported by the additional capacity to improve overall performance of distribution entities in Europe and Saudi Arabia.

Abdallah Massad: We will continue to implement our strategies and expect to yield positive results in 2019. After allocation of land and gas for manufacturing facility in Saudi Arabia, we will implement the project as fast as possible.

Abdallah Massad: We will continue investing in upgrading our machinery to reduce the cost of production and especially which is related to the cost of energy, which we have a disadvantage, as we mentioned, in the UAE. We will continue our product differentiation by investing in R&D through collaboration with known design houses and the introduction of new marketing tools.

Abdallah Massad: Thank you for listening and for your time. I would like to hand the call over to the operator and open the line for questions. Thank you again.

Operator: Thank you. Ladies and gentlemen, we'll now start question-answer session. If you wish to ask a question, please press 0-1 on a telephone keypad. Thank you for holding until we have our first question.

Operator: Our first question comes from Sameer from EFG Hermes. Please go ahead.

Sameer: Hi. Thanks, Abdallah and Chand, and thanks for your call. I have a couple of questions. First is on your hedging plan. So what level of margins are you targeting by hedging the gas price? That's the first one, and... is there any impact of IFRS in your first quarter results?

PK Chand: IFRS impact on hedging, you meant to say?

Sameer: Yeah. Well, what's the total impact you've seen in your first quarter results so far?

PK Chand: As far as the hedging on gas is concerned, we started hedging towards the end of 2018, and what we do is, we have hedged Brent crude with three-months average duration period, and then it impacts the gas price, so until first quarter of 2019, it has not impacted any gas price.

PK Chand: As far as whatever hedging we have done, if, let us say the oil price remains at 70 dollars level. Then the annual savings compared if we have not hedged is around, 5 to 6 million dirhams, so that is as far as our hedging on gas is concerned.

PK Chand: As far as IFRS is concerned, we have not accounted for anything as far as hedging is concerned, so far.

Mohamad Haidar: [crosstalk 00:22:04] 1.4 million.

Sameer: Oh, okay. Got you. I have one more question on the Indian business. [crosstalk 00:22:14]

PK Chand: Yeah, please go on, Sameer.

Sameer: All right, Mr. PK. Since you mentioned the ban on coal gasifiers in India and how it is going to impact, but if you built a capacity in Morbi, and how was your plan? Was it completely based on the gas, or was it gas plus any coal gasifiers? [crosstalk 00:22:47]

PK Chand: Yeah, we invested into two plants. The latest plans, which is for the big slabs, is fully on gas, which we don't have any gasifiers. The plants which we invested in wall tiles, the expansion, which we've done it in gas, the older part was in coal gasifier, which we changed it into gas so that we don't have any impact coming from there.

Sameer: So you are not expecting any additional cost?

PK Chand: No, no, we don't have... Actually, this will help us to improve our cost because all the unorganized manufacturer whose costs are lower on coal gasifier will increase when the produce on gas as they have to pay the price of gas or price of energy, which we are paying, and the whole price is expected to move on. For our cost of production, we don't have an increase in cost.

Sameer: Okay, I have one more question on that cost. So how much is the difference between coal gasifier and the natural gas? What's the cost difference?

PK Chand: It will be around 40% difference.

Sameer: Oh, okay, Got you. Thank you all, gentlemen.

PK Chand: Thank you.

Operator: Ladies and gentlemen, as a reminder, if you wish to ask a question, please press 0-1 on a telephone keypad. Thank you for holding.

Operator: Our next question comes from Michael Said from CI Capital. Please go ahead.

Michael Sayed: Good afternoon, gentlemen. I have the first question involving the revenue of Q1 2019 which is low and also I have feeling that the second quarter will be not a strong one given that we have Ramadan next week, so can you give us more idea? And you said that you are more optimistic. Then you see goals in Saudi Arabia in construction segment. So how would this be reflected on your revenue for the coming quarters? Not the second quarter but for the remaining three quarters of the year.

Abdallah Massad: As we mentioned, that yes, the revenue was low the first quarter. In fact, it is related to two factors. One is we pushed a lot in last year December and this year we started in controlling the receivables and the working capital. Also, there was not much sale in January, but it was later picked up in February as well as in March. Also, the non-availability of trucks for Saudi for a reason, we had almost 850,000 square meters sold, but we were not able to find trailer to dispatch for Saudi. This problem has resolved in April, and we saw a big movement to back log order from Saudi, which we are able to execute, so I do not see.. Look, I know that there was a drop of 6% in sales, but I'm confident that this reduction, we will be able to recover it going forward.

Michael Sayed: I'm not sure if you would be comfortable or not to give a guidance regarding this full year, 19 numbers. So we should expect an upward trend or a downward trend, or a decline or not in revenue for the full year?

Abdallah Massad: Look, as you know, we don't give guidance, but I don't see a downsize in the total revenue this year.

Michael Sayed: Okay. Thank you very much. And just, another question regarding the right of provision on the inventories because that changed a lot over the last two years, and you changed your strategy when it comes to accounting for any write- offs provisions. So you had exact 6.5 million in one 2019, so how should we be expecting this going forward for the coming quarters?

PK Chand: Now, as far as inventory provisioning policy is concerned, that is applied in every quarter, so based on that, since all the inventories are already getting provisioned quarter after quarter, so I do not foresee that a big provision will come in... so it could be like similar provision, which has been in the last two years.

Michael Sayed: Okay. Okay, thank you very much. Thanks.

Operator: Our next question comes from Anoop Fernandez from SICO from Please go ahead.

Anoop Fernandez Yeah, good afternoon, gentlemen, and thanks for the opportunity. Abdallah, earlier in the call, you mentioned something about the number of traders, the Council [inaudible 00:28:40] in Saudi, and that sort of had an impact on your volume.

Anoop Fernandez: Could you please elaborate a bit on what is happening on that front? I think there was some form of Saudi [inaudible 00:28:48] that was expected to kick in earlier this year. If you could just give us some color on what's really happening on that front.

Anoop Fernandez: Secondly, with reference to the Morbi issue that you highlighted earlier, do you see any impact on the pricing of tiles in GCC because of this issue with the cost curve potentially rising there as these compliance course, environmental compliance course or the higher gas prices kick in there, and in a way of pricing, sort of tiles price especially, possibly bottoming out maybe by sometime late last year, have you seen the bottom end in tiles prices here, or do you still see some impact from Indian imports or Chinese imports sort of distorting the pricing here? Thank you.

Abdallah Massad: Thank you for your question. For a reason, maybe the number of traders because of lower business in the last two, three years, went down in the market, and suddenly, we found that we have a problem, that we have many orders from traders from projects which we are not able to find trucks for them, and the backlog was 850,000 square meter, where it's more or less 400 trucks backlogged.

Abdallah Massad: We saw in April, things improved, and it might be due to two reasons. One is increasing the demand overall in Saudi or the movement of material from the UAE to Saudi, or a reduction of the number of trailers were working in this industry, but this issue has been now passed, and we saw an improvement, a big improvement, in April, and the cost of production, of whatever you say on the gas, gasifier in India, for sure, the prices will increase.

Abdallah Massad: The price in the market, I can see that there will be an improvement because we saw the bottom. It cannot be the prices as low as it is now, and you see all our strategy, as Rak Ceramics, was different than our peers is by working on our branding and maintaining our margins, control our costs and not to go into the fight on the non-marginal products, only for the sake of growth, and this, we will continue doing, and I can see that, yes, it cannot be lower than this price is today.

Anoop Fernandez: Okay. Thanks for that. Just to follow up, what is the pricing of gas, in India in Morbi currently, and how does it compare with what you pay for gas in the UAE?

Abdallah Massad: The gas in India now has increased, and as such, above $12, which last year, was to $8, approximately. What we pay in the UAE is around $11 today, which is slightly lower than what is paid now in India.

Anoop Fernandez: Okay. Thanks. Thanks a lot, Abdallah. Thank you.

Operator: Our next question comes from Abdulaziz [Sayeer from Al Rajhi Alpha Please go ahead.

Abdulaziz S: Hi. Good afternoon. Thank you for the call, gentlemen. I have one question on your expansion to Saudi. How much do you expect to save in terms of gas costs? When you do expand then, what's the impact on your net income? Thank you.

Abdallah Massad: Okay, Abdullah. Thank you for your question. In fact, if you see that, for a 10 million square meter production yearly, we would use... I don't have the documents in front of me, which is, plus or minus, it's about 50 million dirhams

Abdallah Massad: [inaudible 00:34:03]

Abdallah Massad: This answers your question, Abdullah?

Abdulaziz S: Yes, thank you.

Operator: Ladies and gentlemen, as a reminder, if you wish to ask a question, please press 0-1 on a telephone keypad. Thank you for holding.

Abdallah Massad: Okay.

Operator: One second. Ladies and gentlemen, if you wish to ask a question, please press 0-1 on a telephone keypad. We have a followup question from Sameer [inaudible 00:34:41] from EFG Hermes Please go ahead.

Sameer: Hi. I have two more questions. First, on your Saudi joint venture integration. So when do you expect that integration to complete and to see the synergy flow into your financials? And second one is on your cost [inaudible 00:35:01]. I've seen one of kind of a cost happen in this quarter, like a depreciation of right of use, which is around 5 million than additional finance costs because of some unwinding lease liabilities.

Sameer: So, this will be reoccurring in nature or just kind of one off because of accounting difference?

PK Chand: Yeah, Sameer. You asked two questions. So one is regarding the Saudi JV integration. We had two entities in Saudi, [inaudible 00:35:32] entities. So these have already been consolidated as far as our financial circumstance. Now, what we are trying to do is, there are two legal entities, which we are trying to combine as one legal entity, so the benefits of the integration, I will say most of it has already come in. It is only a question of legal entity. Instead of two, it'll be becoming one. Clear?

Sameer: Okay. Yeah, got it.

PK Chand: [crosstalk 00:36:01]

PK Chand: And we have already seen the benefits because of it, and the rationalization on [inaudible 00:36:07] expenses, the warehouses. At the end, we had seven warehouses. Now we have two, three warehouses, so a lot of expenses, manpwer rationalization all have happened.

PK Chand: Now, as far as your question on depreciation of right of use, as it is concerned, that is all because of IFRS 16, which is on leases. Now, as far as 16, there were a lot of expenses which used to get debited to the rent account, which, instead of coming to rent account, part of that, it goes to interest. Part of that goes to depreciation, so it is all as for IFRS which is mainly coming from the warehouses and showroom rentals.

Sameer: Oh, okay.

PK Chand: So if you go through IFRS, you will understand the [inaudible 00:37:04], and it will continue to be accounted for like... yeah.

Sameer: Oh, perfect, perfect. Thanks a lot, Chand.

Operator: Our next question comes from Mohamad Haidar from Arqaam Capital. Please go ahead.

Mohamad Haidar: Quick question on the product capacity, please. Therefore, we have seen 6% growth in sanitaryware and 27% growth in Europe specifically. I'm assuming this is coming from UAE production. Assuming sanitaryware continues to grow, do you still have capacity to produce more within existing plants?

Abdallah Massad: Look, regarding the sanitaryware, we are almost at full capacity in UAE, but we can ramp up. So what we are starting doing, we are utilizing the extra capacity we have in India to export out where it will support the efficiency in the production in our plants in India.

Mohamad Haidar: Okay, and does this come at slightly lower margins due to transportation costs, coming from India?

Abdallah Massad: It is going directly, so it does not come here and get exported, so we export it directly.

Mohamad Haidar: Okay, understood. Thank you, Abdallah.

Abdallah Massad: Welcome.

Operator: Ladies and gentlemen, as a reminder, if you wish to ask a question, please press 0-1 on a telephone keypad. Thank you for holding.

Operator: Our next question comes from Ibrahim [Attiya 00:38:50] from HSBC TCA. Please go ahead.

Ibrahim Attiya: Thank you for the presentation. I just have one question. What's your outlook for ceramic tiles in Saudi Arabia and the overall outlook of the building construction in Saudi Arabia? And when do you expect the demand to pick up?

Abdallah Massad: Look, there is no doubt that... For us, we differentiate with ourselves in terms of product and different product that what is produced, and we do expect to grow. In terms of market, also we can see some improvement coming from the positive demand coming from the dealers, where they expect more sales.

Abdallah Massad: Unfortunately, the prices are still under pressure, but I do believe that 2019 will be like its [inaudible 00:39:58] year, and some improvements in the pricing and margins, we might see it in 2020.

Ibrahim Attiya: Thank you.

Operator: Ladies and gentlemen, as a reminder, if you wish to ask a question, please press 0-1 on a telephone keypad. Thank you for holding.

Operator: Once again, ladies and gentlemen, if you wish to ask a question, please pess 0-1 on a telephone keypad.

Operator: We have no further questions. Dear Speaker, back to you for the conclusion.

Mohamad Haidar: Thank you, everyone for joining the call. Abdallah and PK Chand, thank you very much, and have a nice day, everyone.

Abdallah Massad: Thank you, thank you very much. Thank you, everybody.

Operator: Thank you. This concludes today's conference call. Thank for your participation. You may now disconnect.