

R.A.K. Ceramics P.J.S.C. ADX:RAKCEC

FQ1 2023 Earnings Call Transcripts

Monday, May 15, 2023 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2023-			-FY 2023-	-FY 2024-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS
EPS Normalized	0.05	0.07	▲40.00	0.38	NA
Revenue (mm)	880.00	882.38	▲0.27	4068.00	NA

Currency: AED

Consensus as of Apr-18-2023 3:46 PM GMT

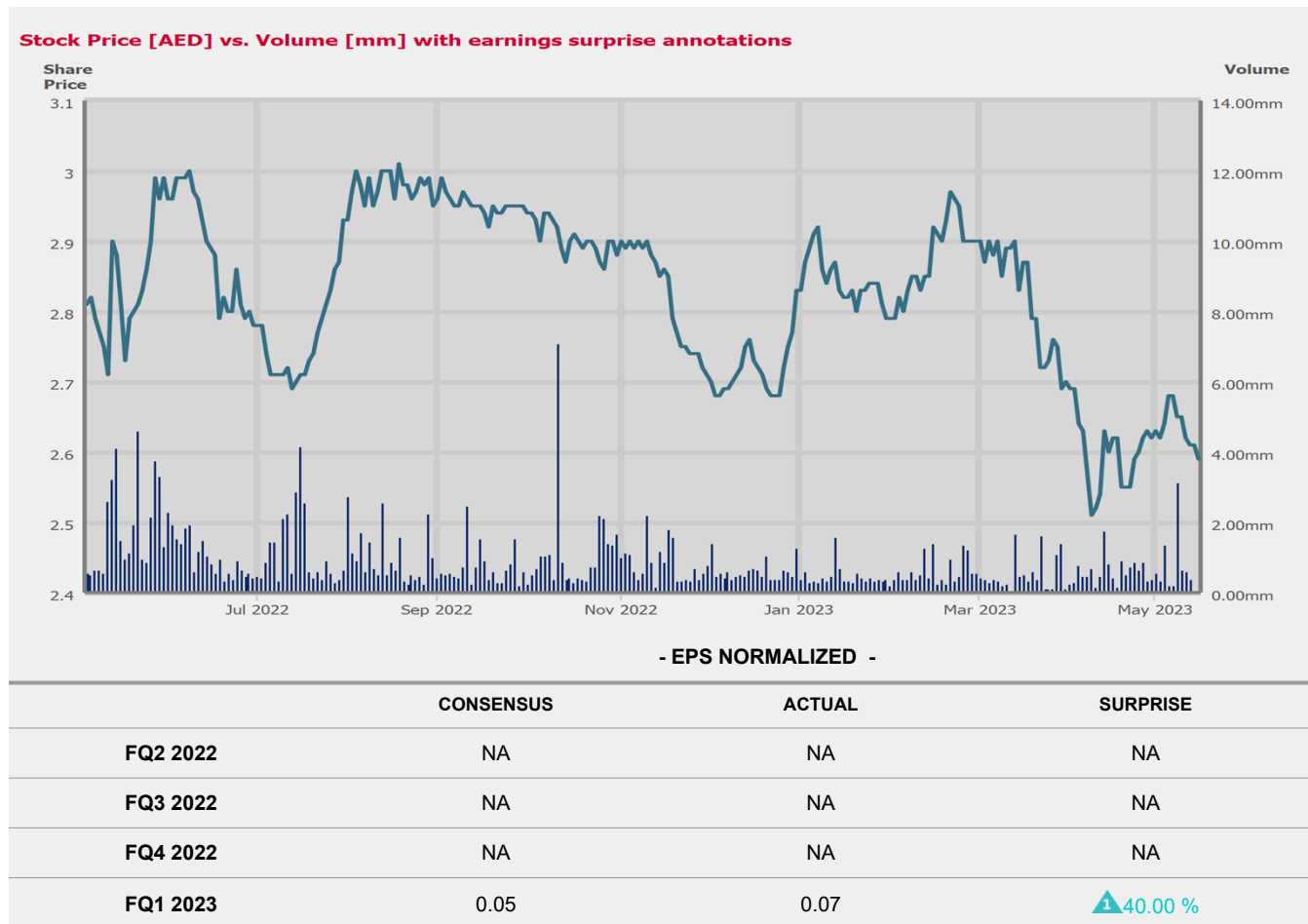


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Call Participants

EXECUTIVES

Abdallah Massaad

Group Chief Executive Officer

Pramod Kumar Chand

*CFO & Interim Head of Investor
Relations*

ANALYSTS

Anoop Mark Fernandes

*Securities & Investment Company BSC,
Research Division*

Mohamad Haidar

*Arqaam Capital Research Offshore
S.A.L.*

Sameer Kattiparambil

*EFG Hermes Holding S.A.E., Research
Division*

Presentation

Mohamad Haidar

Arqaam Capital Research Offshore S.A.L.

RAK Ceramics First Quarter 2023 Earnings Call and Webcast. This is Mohamad Haidar from Arqaam Capital, and we are joined today by Mr. Abdallah Massaad, Group CEO from RAK Ceramics; and Mr. P.K. Chand, Group CFO from RAK Ceramics. Over to you, Mr. Abdallah.

Abdallah Massaad

Group Chief Executive Officer

Thank you, Mohamad, and good afternoon, everyone. Welcome to RAK Ceramics First Quarter 2023 Earnings Conference Call and Webcast. We are pleased to announce that our company has registered strong first quarter revenue and net profit results as we continue to strive the ways in these challenging times. We registered a revenue growth of 12.7% from last year to reach AED 882.4 million and our net profit also increased by 14.9% from last year, reaching AED 80.1 million.

Our performance was mainly driven by the tiles and tableware segments and our strong foothold in the UAE market. Our focus remains on upgrading our brand position in our core markets by expanding our retail presence through showroom refurbishment and additions. Our commitment to innovation and digitalization is reflected through the introduction of new products, further enhancing our offerings.

Let me now take you through a more comprehensive update on our business performance region by region. In the UAE, we had a strong performance driven by project channel business attributed to the rising real estate market growth in the UAE. We have maintained our margin despite facing challenges in terms of competition from increasing imports.

E-commerce has continued to pick up following increased marketing efforts. Our performance in the Saudi Arabia market continue to face challenges due to intense competition and the price war from local manufacturers. Nevertheless, we remain committed to our premium positioning and differentiated product strategy, which has allowed us to strengthen our position in the retail and project segment.

We plan to expand our retail footprint by opening new showrooms in the coming quarters. Our sales in other Middle East markets have shown growth potential, especially through project channels, we continue to focus on strengthening our brand position in these markets as we face rising competition from regional manufacturer.

As Europe struggles with the looming recessionary feels, our performance has been resilient in Germany and in Italy, with demand in the U.K. declining, specifically for sanitaryware segment. However, we remain confident about our growth prospects in Europe given the reduction in freight rates. In India, we witnessed a nominal decrease in revenue on constant currency basis, mainly due to slowdown in the construction sector and tight liquidity caused by an increase in interest rates.

Although we faced challenges due to currency devaluation, we continue to expand our dealer network and open new showrooms to improve our position in the Indian market. Our performance in Bangladesh remains stable on a constant currency basis, even though we were impacted with a regular gas supply pressure, coupled with increased price and currency devaluation. Despite these challenges, we continue to expand our showroom network and focus on market penetration and product differentiation.

Our tableware business registered robust performance on the back of a successful launch of a new series of products and benefiting from growing demand mostly from regional markets. Revenue from KLUDI remained stable with a slight decrease mainly due to currency devaluation and the drop demand in Europe as a result of a geopolitical and economical challenges.

Despite these challenges, we are confident in the future prospect of KLUDI as we continue to implement our turnaround plan with the aim to transfer KLUDI into a high-end international sanitaryware and faucet brand. As we remain committed to innovation and technology, we continue to execute strategic initiatives that drive the power of Industry 4.0.

Our recent initiatives involves the launch of our Smart Factory in the UAE, focusing on GP tile production. Additionally, our tableware capacity expansion by 10 million pieces is scheduled for completion in third quarter 2023. Regarding our 2 greenfield projects, we continue to make progress in setting up faucets plants in Bangladesh and Tiles plant in Saudi.

We are deeply committed to sustainability and have made substantial investment in new technologies to minimize our environmental footprint. By implementing multiple eco-friendly processes, we continue to prioritize our environmental responsibility. As we

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navigate through a challenging business environment, we are facing multiple headwinds, including the increase in gas prices, rising interest costs, devaluated currencies and the looming economic slowdown.

To address these challenges, we have increased our prices in line with the market shift, and we continue to work towards improving production efficiency and optimizing costs. We remain focused on differentiated products and the brand enhancement to improve our customer value proposition as our industry continues to navigate through market uncertainties and economic challenges, we remain committed at creating value for our shareholders. I will now hand over to PK, our CFO.

Pramod Kumar Chand
CFO & Interim Head of Investor Relations

Thank you, Abdallah. Good afternoon, everyone, and thank you for joining us. Mr. Abdallah has already briefed on operational highlights, key markets and strategy update for the first quarter of 2023. I will take you through the financial highlights with details on revenue, gross profit margin and the balance sheet.

We will start from Slide 12. RAK Ceramics delivered a strong set of results this year, supported by strong operational capabilities despite navigating through all these on challenges like higher interest rates, currency devaluation, recessionary fears in major markets and increased competition.

Total revenue in the first quarter increased by 12.7% year-on-year to AED 882.4 million. KLUDI Group consolidation has added AED 105.1 million to the revenue. Excluding KLUDI, revenue is slightly lower by 0.7% year-on-year, which is predominantly due to currency devaluation. On currency rates of last year, revenue increased by 3.5% year-on-year, excluding KLUDI Group consolidation.

Tiles and sanitaryware revenue is lower by 3.1% year-on-year at AED 650.1 million, mainly due to lower sales in sanitaryware. This decline is primarily due to lower offtake in European markets, given ongoing economic challenges and disruption in Bangladesh business caused by intermittent lower pressure in gas supply.

Tableware revenue increased by 28.9% year-on-year at AED 97.6 million, driven by introduction of differentiated products. Faucets revenue is AED 111.6 million in the first quarter of this year, out of which contribution from KLUDI Group is AED 105.1 million. Revenue from other units decreased by 21.8% year-on-year in the first quarter of this year to AED 23.2 million, mainly due to decrease in our ceramic raw material trading business.

Now we will go to Slide 14, which covers the end market performance in the first quarter for the Tiles and sanitaryware segments. In UAE market revenue in the first quarter increased by 24.7% year-on-year to reach AED 189.9 million, driven by project channel business attributed to the rising real estate market growth in the United Arab Emirates.

In Saudi Arabia, revenue in the first quarter of this year witnessed a marginal decline by 2.4% year-on-year to AED 20.0 million due to aggressive pricing by local competitors, mainly in wholesale and retail channel. Sales from project channel continues to grow. Our focus remains on offering premium products, securing mega projects and expanding the retail footprint.

In India, revenue in the first quarter decreased by 8.5% year-on-year to AED 91 million. While in local currency, it remained stable despite a slowdown in construction sector, liquidity challenges resulting from increase in the interest rate. In Europe, revenue in the first quarter decreased by 10.8% to AED 97.1 million, while in local currency, it decreased by 6.9% year-on-year due to ongoing economic challenges in the region.

However, we have remained -- we remain confident about our growth prospects in Europe given the declining inflation and reduction in freight rates. In Bangladesh market, revenue in the first quarter decreased by 18.6% year-on-year at AED 69.6 million. The macroeconomic challenges and the currency devaluation impacted top line growth as revenue remained stable year-on-year in local currency.

Performance also impacted due to increase in gas price. However, the focus is to continue expanding the showroom network with a focus on market penetration and product differentiation. In Middle East, excluding United Arab Emirates and Saudi Arabia, revenue decreased by 2.7% year-on-year at AED 35.3 million.

Now we will turn to Slide 15. Total gross profit margin in the first quarter increased by 19 basis points year-on-year to 37.9%, driven by higher margin in tiles and tableware segment. Tiles margin in the first quarter increased by 360 basis points year-on-year to 38.9%, mainly due to change in product mix and higher sales in UAE end market. Sanitaryware margin decreased by 260 basis points year-on-year to 36% in the first quarter, mainly due to lower revenue and higher energy price.

Tableware margin increased by 150 basis points year-on-year to 50.3% in the first quarter following top line increase and change in product mix. Noting that KLUDI Group consolidation was effective 1st of June 2022, profit margin stood at 26.6% as of the first quarter 2023 compared to 16.7% in the fourth quarter of 2022.

Reported net profit is AED 80.1 million in the first quarter of this year compared to AED 69.7 million in the same quarter last year. Net profit margin is 9.1% for the first quarter compared to 8.9% in the last year. EBITDA for this first quarter is AED 157.1 million compared to AED 129.7 million in the last year, and the margin is 17.8% compared to 16.6% in the last year.

Now we turn to balance sheet highlights on Slide 19. Overall working capital increased by AED 111 million quarter-on-quarter to AED 1.52 billion in the first quarter, mainly due to increase in receivables for Ramadan and reduction in trade payables, due to lower purchases. Working capital days increased to 156 days in the first quarter of this year.

Inventory days reduced from 197 days to 191 days quarter-on-quarter, mainly due to lower raw material purchases made during the quarter. Trade receivable days increased from 84 days to 88 days quarter-on-quarter, mainly due to Ramadan. Trade payables decreased from 63 days in the fourth quarter of 2022 to 52 days in the first quarter of this year, mainly due to lower purchases made during the quarter.

Net debt increased by AED 157.7 million to AED 1.46 billion in March 2023, mainly due to payment of AED 112 million as dividend and increase in working capital. Net debt to EBITDA increased to 2.42x in March 2023 versus 2.26x in December 2022. We continue to maintain adequate liquidity position during the quarter. Capital expenditures during the quarter has been AED 44.7 million, and CapEx guidance for the full year of 2023 continues to be at AED 300 billion to AED 350 million.

Now Slide 18 shows the share price movement during the last 12 months. The shares are currently trading at PE multiple of 9x. Now I would like to turn back to Mr. Abdallah for his final comments, on the rest of the quarters of 2023 priorities before we answer your questions.

Abdallah Massaad
Group Chief Executive Officer

Thank you, PK. As we conclude the first quarter for 2023, we are delighted of our achieved progress and growth. This has been our best first quarter with strong growth in top line -- both top line and profitability. Despite the current challenging environment and this growth is testament to our solid operational fundamentals. Our priority set for 2023 remain aligned with our objectives with a focus on protecting market share and maintaining healthy competition, expanding production capabilities exploring new markets, accelerating digitalization, strengthen retail presence and turn included into a global high-end faucet and sanitaryware.

We also plan to optimize operations and mitigate rising risks while implementing a sustainability strategy to generate sustainable growth and long-term value for shareholders. Lastly, we do acknowledge the challenging time that lies ahead of us this year as a multinational company catering to the global market, we will strive to maintain our position in recessionary markets while driving performance and regions exhibiting growth opportunities, even though we expect more pressure on our revenue growth in the coming period, our focus will remain to maintain and improve our margins.

We remain firm in our commitment to deliver value to our customers, employees and shareholders as we navigate these challenges in the second quarter 2023. Thank you for your time. Now I would like to hand over the call to the operator and open the line for questions.

Question and Answer

Operator

[Operator Instructions] We have a question from Sameer Kattiparambil from the EFG Hermes.

Sameer Kattiparambil

EFG Hermes Holding S.A.E., Research Division

A few questions on the KSA. Can you quantify how big is the competition from the local players? And are you seeing a change in the intensity of competition quarter-on-quarter for good or for worse? And second is on your faucet business, its margin has improved to 26%. So what level are you targeting for this year? And what's the bottom line look like for this segment in the first quarter?

Abdallah Massaad

Group Chief Executive Officer

Thank you, Sameer for your question. Regarding Saudi, it is known now, I believe, and you can see it in the regional balance sheets of the companies where you have 3, 4 in Saudi. And basically, there is some overcapacity in the ceramics sector and they went into a price war where the prices, especially in the commodities or the entry level came down in a significant way.

Our position, Sameer and what we are saying since 2014 is focusing on upgrading our brand, working on the brand positioning, image innovation, differentiation, quality, reliability. Honestly, we are good, and the wholesale sector get impacted, whereas we have a growth in our project business, where we have a better margin. And we can see that it is becoming more and more difficult, especially probably more projects will come in the market.

And when the project comes demand will rise, then the competition will also relax. In terms of our KLUDI consolidation, this is the thesis why we acquired KLUDI. We acquired KLUDI because they have historically lower margins, especially in Europe because the manufacturing footprint is basically in Europe and they were not able to increase the selling price.

So the whole thesis was to use the factory which we have at Ras al-Khaimah and we already started doubling the capacity. We had the capacity of 0.5 million pieces. We are doubling to be 1 million pieces closing and restructuring some factories in Europe as well as increase our prices. We saw during the quarter that our margin improved to 26%. Our target is to be above 30%, hopefully by reaching by end of the year, till now, we're still in the consolidation level, we incurred losses, and we expect that things by the fourth quarter or end of this year will turn around in this acquisition.

Sameer Kattiparambil

EFG Hermes Holding S.A.E., Research Division

Maybe one follow-up question on the UAE market because in the first quarter number and most of your performance were mainly from the UAE operation, which grew by 24%. What is the risk you are seeing in this market? Is there any kind of working capital cycle issue or are you expecting?

Abdallah Massaad

Group Chief Executive Officer

Sameer, our focus that we are a multi-national company, and we don't focus on one market, but always there is an evolution and there is a cycle happening everywhere. So yes, in the UAE, there is a boom in the state sector. And to be honest, we are well positioned from a reliability, from a consistency and the availability of products.

Despite that, we have a lot of competition, especially that the antidumping has been lifted and a lot of import is happening. But still in the project sector, we -- as the clients prefer to have a reliable supplier, and we are well positioned in this way.

Now the risk I see going forward that the projects are still coming up. So we -- it is an opportunity during this time. Meanwhile, we are performing also good in the export market, as we mentioned, now by reducing the freight, which gets reduced. This will give us an opportunity in the exports as well as the currency devaluation, which we had last year, especially in the pound and euro, we do not have it this year or it has improved, which will support our performance in the export markets.

Operator

[Operator Instructions] We have trio of text question from Alok Nawani from Ghobash. Can management provide any update on the strategy behind the plot of land in RAK? Would you expect the effective tax rate for RAKCEC in 2024 following CIT implementation and how will this impact the company's dividend policy? And finally, which markets have been most impacted by currency depreciation?

Abdallah Massaad
Group Chief Executive Officer

Let me start the answer and PK will follow with the number, but we are still at our announcement on regarding the land that we are not going to develop it ourselves, and we are searching a buyer to sell it, or a strategic investors. I do believe that our position is much better, especially on the appreciation of the value of the real estate in Ras al-Khaimah.

And regarding the dividend policy, I do not see any changes in our policy of dividend and the tax element will not impact our dividend policy, which was approved earlier by the Board. In terms of quantifying the tax, PK, if you can?

Pramod Kumar Chand
CFO & Interim Head of Investor Relations

Alok, you know that as far as UAE corporate tax is concern and it pertains to what has been announced. Now based on the Pillar 2 implementation of bets, where the revenue crosses EUR 700 million of threshold in 2 consecutive years, we are most likely going to get covered under that threshold.

So that means we will exceed the revenue of EUR 750 million. But based on the global minimum tax, which is being discussed at 15%, what will be the tax rate in UAE, that is still not clear, but it could be either 9% or it could be 15%, but it is not yet announced. So it is very difficult for me to give you what is going to be the effective rate of tax.

If it is 9%, then obviously, it will be 9% for the UAE. And if it is for 15% based on the global minimum tax, then it will be 15%. As far as the currency depreciation is concerned, you wanted to know which countries got impacted. So the most impacted country is Bangladesh, India and then European. But Europe, the currency has gone better now, but what is going to be during the year that we will have to see.

Operator

We have an another text question. When is the expected time to start the Saudi Arabia factory?

Abdallah Massaad
Group Chief Executive Officer

Look, honestly, we are into active communication with the Ministry of Industry and Authorities in Saudi in order to get the gas allocation for the land, which we have, honestly, as we announced that the gas was promised to reach by 2026.

And accordingly, we are in touch, we don't want to start the project and then we have the risk of gas allocation or gas connection. We will -- I hope that by the next call, we'll have an update on this.

Operator

You have one further text question. What is the utilization levels for tile and sanitaryware segment countrywide?

Abdallah Massaad
Group Chief Executive Officer

Capacity utilization in tile is above 80%, and in sanitaryware is above 75%.

Operator

We have no further questions at this time. [Operator Instructions] We have an audio question from Anoop Fernandes from SICO.

Anoop Mark Fernandes
Securities & Investment Company BSC, Research Division

Congrats on a great set of numbers. I have -- my questions are regarding the Saudi business. What's happening there on the supply side? I mean have the supply additions, are they all behind us? Or are you expecting supply to come online in future as well from your competitors?

And if you could give us some color on the demand equation there. So the long-term undercurrents are obviously very bullish, but what is happening there at the moment? I mean are you seeing a slowdown in activity on the construction real estate side?

Abdallah Massaad
Group Chief Executive Officer

Look, no doubt, the interest rate, which has been also hit the private sector in Saudi, reduced the real estate activities, not on the mega project or the government projects, but at least in the private sector. Which happened across the board, yes.

So what we saw that, as you mentioned, the demand from the private sector has reduced and some projects get delayed into the -- it was announced but delayed in the process, plus the additional factories, which came with an extra volume.

And in order to get market share, it was a reduction in prices. And therefore, we saw a severe competition this means the local factories on the price matter, which we decided as a company that we will follow strictly on not reducing and improving and maintaining our margins by differentiating our sales in term of product, on designs, on sizes from the supply as well as focusing on the mega project and government projects, which requires specification and quality.

Anoop Mark Fernandes
Securities & Investment Company BSC, Research Division

So is it fair to conclude that Saudi Arabia now is self-sufficient as far as tiles is concerned, and there is no need for imported material? Because in the past, imports used to be a significant portion of total supply because it's kind of surprising that prices would drop to such a level.

And also -- I mean, is the supply addition behind us? Or are you expecting newer supply to come online within the next, say, 1 or 2 years?

Abdallah Massaad
Group Chief Executive Officer

Look, Anoop, what -- yes, I can say that if we look at what is demand in Saudi and what is the capacity, you can say that the installed capacity and the increase in capacity, which gets declared from factories exceed the demand in the local market as on today.

But also, it is fair to say that we are not into a pure commodity play. And yes, there is a supply demand, but on the end, there will be still always a demand for a differentiated products. And therefore, in a segment of pure commodities, the pressure and competition and prices will be more and more because it's -- the fittest will survive.

While -- that's why we say that we are differentiating ourselves and also playing on a branded as well as differentiated level. We heard -- we don't have much but we heard that many of the factories which they announced actually an increase in capacity. They put it on hold as no one was expecting this lower in demand and the pressure in pricing, which has happened in the first quarter.

Operator

Next question is a follow-up from Sameer from EFG Hermes.

Sameer Kattiparambil
EFG Hermes Holding S.A.E., Research Division

Just a follow-up on the Bangladesh market. What's the current status in terms of the gas availability? When do you think operations to normalize?

Abdallah Massaad
Group Chief Executive Officer

Sameer, they increased the prices. We have a big increase in prices. And honestly, we can say that at the moment, we are getting the supply on gases, which we need the last 1 month, I believe it is stable with the increases in prices.

Sameer Kattiparambil
EFG Hermes Holding S.A.E., Research Division

Okay. What's the increase of the gas price? Could you please remind me on that?

Abdallah Massaad

Group Chief Executive Officer

The gas price was \$3.5 per million BTU, which was increased to \$8 per million, approximately.

Operator

We have any further questions at this time. [Operator Instructions] As we have no further questions, I'll hand back to the management team for any concluding remarks.

Abdallah Massaad

Group Chief Executive Officer

Thank you very much.

Mohamad Haidar

Arqaam Capital Research Offshore S.A.L.

Thank you, Mr. Abdallah, and thank you, Mr. PK Chand and to everyone for joining today. We look forward to having you all with us next quarter. Have a nice day.

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