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Operator: Ladies and gentlemen, welcome to RAK Ceramics Quarter 2 2017 results conference call. I will now hand over to your host, Mr. Mohamad Haidar. Sir, please go ahead.

Mohamad: Good afternoon, ladies and gentlemen, and welcome to the RAK Ceramics second quarter 2017 earnings conference call hosted by Arqaam Capital. This is Mohamad Haidar from Arqaam Capital Research and I'm joined today by RAK Ceramics' management team -- Mr. Abdallah Massaad, CEO; and Mr. PK Chand, CFO. Without further delay, I will now hand over the call to Mr. Abdallah. Please, go ahead.

Abdallah: Thank you, Haidar. Good evening, everyone, and welcome to our second quarter 2017 results conference call and webcast. I'm Abdallah Massaad, CEO of RAK Ceramics, and I will walk you through the key business update for the quarter. I'm glad to report that the second quarter of current year has also shown positive and promising results. Various strategic decisions taken since last November have proved fruitful. Our focus on UAE market, optimized production in UAE, initiatives taken in Bangladesh to push sales, and keeping manufacturing costs and overheads under control resulted in overall good performance.

Now, I'll start with the key business update in Page 4. As far as regional markets are concerned, UAE market continues its strong growth led by robust project sales. We have strengthened our project sales team, and the result is encouraging. Distributor sales also performed better. In Saudi Arabia, competition in ceramic tiles continues to be strong, but we are gaining momentum in GP tiles and also from bigger format ceramic tiles, which is not produced in all the factories installed in Saudi. With a slightly better economic mood in Saudi, wholesale markets have picked up, but project sales remain low. Saudi Arabia continued to show a recovery trend, but sales remained lower than the previous years.

In MENA, revenue continued to be under pressure due to the macro and political situation. Revenue from Europe continued to underperform due to competitive pressure from local suppliers on average selling price because of weak Euro and pound. To counter the challenges mentioned above, we had announced the changes to our production capacity to optimize results based on market demand. Presently, our capacity of ceramic tiles is 63% of our total production and the GP tiles is 37%, against 73% and 27% respectively in the first half of 2016.

Further, manufacturing costs were kept under control by increase in production efficiency by further tuning up the production process, savings in raw material costs on improved purchasing and formulation. As a result of the above initiatives, tiles gross margins recorded highest since 2014. In Bangladesh, revenue both year-on-year and quarter-on-quarter grew following last year's capacity expansion, and initiatives taken to push sales by organizing Dealers Meet and offering incentive schemes. Gross profit margins in tiles were also higher, while sanitaryware gross profit margins remained stable.

Bangladesh entity is listed separately on Dhaka Stock Exchange with a market cap of approximately $260 million. We own 71.67%. Recently, we sold 2% at a valuation of 21.7 times of earning earnings per share to monetize valuation. Our board of directors approved to sell these shares, but to maintain the majority in the Bangladesh subsidiaries and will decide on future partial exits on a case by case basis. In India, as mentioned in our earlier earnings call, we have plans to acquire 51% equity stake in manufacturing facilities in Morbi, Gujarat, adding additional 10 million square-meter capacity. This will bring us in line with the other branded players in India, who have already acquired stakes in multiple outsourced Morbi, Gujarat manufacturing units.

Currently, 50% of our total revenue in India comes from outsourced production from Morbi. By acquiring a controlling stake in manufacturers in Morbi, India will have better access to a flexible, efficient and low-cost manufacturing base close to major markets in the north and west of India. The proceeds from sales of shares of Bangladesh will be used to fund the joint venture acquisition in India. Revenue from India markets has increased both in year-on-year and quarter-on-quarter, showing further opportunity of growth.

In SG&A, focus on savings continued with stringent control across the group. Net finance costs have also decreased, despite higher LIBOR, mainly due to better forex management. To improve profitability, we continued reliance on core operations and product portfolio optimization, with more value-added products. We currently working on new products and sanitaryware collections to be presented at Cersaie Fiar in Italy, in September 2017.

We are glad to report that EBITDA margins during the quarter have been a five-year high at 20.4%, and return on equity has been 17.2%, an all-time high. As part of our value creation plan to exit non-core operations, we have divested 50% of our stake in RAK Warehouse Leasing to RAK Investment Authority owning the other 50%, at the consideration of 125 million dirham. Extraordinary net gain of 34.8 million dirham has been recognized in the second quarter of 2017 financials.

Now, we move to Slide 5. Strategic initiatives updates on India and Bangladesh have been briefed, in Saudi Arabia, we have two joint venture entities and a representative branch office. We have reached agreements with our joint venture partners to acquire their stakes, giving us full control of operations in Saudi. This will consolidate the operations in the Kingdom, integrate operations with head office, open up new channels and customers in one of the core markets, and break current reliance on a handful of customers. It will drive further profitability improvements through back-office synergies, infrastructure consolidation, and a more focused sales and marketing setup.

I will take you through the key financial highlights in Page 6. Core revenue at 661 million dirhams increased by 6.5% quarter-on-quarter from strong growth in the UAE, Saudi, Bangladesh, and the tableware business. However, it remains stable year-on-year. Non-core revenues at 59.9 million decreased by 37.6% year-on-year and 1% quarter-on-quarter, which is in line with the company's strategy to divest non-core operations and delivering on the value creation plan. Core gross profit margins increased by 450 basis points to 34.2%, compared to the same quarter of last year by 210 basis points quarter-on-quarter.

Total EBITDA was 146.8 million dirhams with margins grew to a five-year high at 20.4%, up by 130 basis points year-on-year. EBITDA from core operations increased 128.8 million with margins of 19.5%, up by 380 basis points year-on-year. Our reported net profit increased 113.2 million dirhams, up by 73.4% year-on-year, 66.1% quarter-on-quarter. Margins improved by 710 basis points to 15.7% year-on-year.

Core net profits increased to 67.9 million, up by 62.9% year-on-year, with increased margins of 10.3%, up by 400 basis points year-on-year. Like-for-like profit, excluding extraordinary net gains and provisions, increased by 7.3% to 85.1 million dirhams with margins of 11.8% compared to the same quarter of 2016, and by 66.1% quarter-on-quarter. Extraordinary gains is mainly on sales of 50% stake in RAK Warehouse Leasing.

Now, I will return the call to PK Chand, our CFO, to brief you on the financial and segment highlights.

PK: Thank you, Abdallah, for briefing the key business update and financial highlights. Now, we will go through the detailed financial highlights. Despite challenging global market and trade conditions, our total revenue for the second quarter has been 721 million, which is lower by 4.7% year-on-year. However, for quarter-on-quarter, it has been up by 5.9%. This is only on account of lower revenue from non-core segments, which is in line with the company's strategy to divest non-core operations and delivering on the value creation plan.

As far as core revenue is concerned, it remains stable at 661 million compared to last year and higher by 6.5% quarter-on-quarter, supported by growth in the UAE, Saudi, Bangladesh, and tableware. Tiles revenue was 476 million, which is lower by 2.1% year-on-year, but higher by 6.8% quarter-on-quarter. Sanitaryware revenue at 123 million remained flat year-on-year, as well as quarter-on-quarter. Tableware revenue at 61 million increased by 20% year-on-year and 18% quarter-on-quarter, mainly due to consolidation of Restofair entity, effective 1 January 2017.

On Slide 8, we show revenue by end market. In UAE, which is the company's largest market, grew in tiles by 13.7% year-on-year, and in Sanitaryware it grew by 10.5%. Growth is led by robust project sales, which increased by 19.7% year-on-year and 13.8% quarter-on-quarter. Distributive sales also performed better with increase of 9.4% year-on-year and remained flat quarter-on-quarter. Revenue from Saudi Arabia continued to be lower year-on-year, but had a steady performance quarter-on-quarter. Tiles revenue increased 32.8%, while sanitaryware revenue has been lower by 17.5% quarter-on-quarter. This steady progress signals continuation of a slow market recovery that started earlier this year. Revenue from MENA continued to be under pressure as evidenced by a 21% decline year-on-year and 6.6% quarter-on-quarter, due to macro and political situation. In Bangladesh, revenue grew by 21% year-on-year and 6.1% quarter-on-quarter, supported by strong tiles revenue growth this quarter following last year's capacity expansion, with tiles revenue increasing by 43% year-on-year and 9.8% quarter-on-quarter. Sanitaryware revenue was flat quarter-on-quarter and remained lower by 9.2% compared to last year due to Eid holidays. Gross profit margin in tiles were also higher at 36.8%, up by 540 basis points year-on-year. In sanitaryware, gross profit margins remained stable at 42.2% in the second quarter of this year. India continued its upward curve trajectory in the second quarter. Revenue grew by 4% at 76.6 million. Revenue from Europe continued to underperform due to competitive pressures.

On Slide 9, we are showing the contribution of core and non-core operations. To improve the profitability, we continued relying on our core operations, and you can see that the non-core operations contributed only 8.3% in the second quarter to a high of 18.6% in the year 2013, and 66% of the revenue is coming from tiles segment.

On Slide 10, we give the details of gross profit margins. We continued to show positive momentum to gross margin improvement for the second consecutive quarter of 2017, and reporting core gross margins at 34.2%, up by 450 basis points compared to last year and up by 210 basis points quarter-on-quarter.

Consolidated gross margins were 33.3%, higher by 380 basis points year-on-year and 160 basis points quarter-on-quarter. Tiles gross margin increased to 30.1%, the highest in any quarter since 2014. Improvements were driven by improved production efficiencies across UAE and Bangladesh tile plants. Sanitaryware margins remained stable as pressure on ASP continued due to weak Euro and pound against dollar. As far as tableware is concerned, margins declined due to consolidation of Restofair effective 1 January 2017. Restofair is engaged in distribution of supplies and equipment for the HORECA industry, and impact on net profits in this quarter is 1.9 million.

On Slide 11, we have summarized the financial highlights with details of performance on core operations. These have already been briefed, and therefore we are not repeating the same. On the cash front, CAPEX has relatively been light in this quarter at 21 million, as the majority of our CAPEX program is scheduled in the second half. Our CAPEX plan for 2017 continued to be 265 million -- 132 million, maintenance, and 133 million, growth. This growth investment will go towards co-generation projects, larger kilns, and hydraulic presses for the UAE operation, with the remainder on setting up our own warehouse for distribution of tableware in Europe, which we currently rent. Out of this 265 million of CAPEX, we expect that in the year 2017 we will spend about 200 million dirhams, while the commitment will be for a total of 265 million. The net debt fell on absolute basis by 3.6% quarter-on-quarter to 1.66 billion, and net debt to EBITDA has reduced to 3.58 times. We expect to finish the year around three times of net debt to EBITDA.

On Slide 12, we are showing the operating cycle. On this slide, it can be seen that the operating cycle has increased slightly due to slower collections in the month of Ramadan, resulting in increase in receivable days from 113 to 122 days. Inventory days have increased mainly due to accounting of duty on Indian finished goods, as per amended accounting standards.

We continue to make further progress on working capital management during the year. Total inventory in the UAE has decreased by around 10% during the first half of 2017, and overall inventory has also gone down by about 2 million square meters. In Slide 13, as far as shareholder return is concerned, we are happy to report that return on equity at 17.2% and return on assets at 8% in the quarter are both at all-time high, and it can be clearly seen that a strategy to exit non-core assets has helped lighten the balance sheet, increase margins and enhance returns for shareholders.

So from the financial highlights it is very clear that various strategic steps like focus on UAE market, optimizing the production, and control on manufacturing and overhead costs are giving good results, and we will continue the same. Now, I will turn back to Mr. Abdallah for his final comments before we answer your questions.

Abdallah: Thank you, PK. On the update of the focus area and initiatives identified at the beginning of the year, in UAE we continue to grow our market share, as we get the highest contribution in this market. Our focus is on the project channel penetration and enhance retail channels, also through our own showrooms, as well as the wholesale network, which we have. A flagship new showroom in Sheikh Zayed Road in Dubai will be opened in the last quarter of this year. In India as informed, we are in the process of finalizing outsourced manufacturing acquisitions, and we hope to complete the transactions before the end of the year.

Recently, we have shifted to a new corporate office to match our status. In India, effective on 1 July 2017, GST, the Goods and Services Taxes has been implemented. GST is a unified tax, which replaced multiple cascading taxes levied by the central and state governments. Due to uncertainties of GST implication of the finished goods inventories, dealers were reluctant to lift the materials in the month of June. However, GST negative impact has started receding slowly and it is expected that shortly the market will become normal.

With regards to Iran, we have planned to start the second line by September 2017 to ramp up a production capacity of nearby 65%. We have completed recruitments to firm up sales structure to focus on the Iran local market. I have already given details on Saudi joint venture restructuring and product differentiation. In tableware, new products are being offered. After launching RAK Ceramics' new corporate identity last year, we have extended the campaign to Bangladesh in the first quarter. We have also completed branding for dealer showrooms in the UAE and India. We expect to extend the campaign to Saudi in the second half. We continue to invest in brand image in United Arab Emirates and India.

Warehouse and logistics optimization in UAE is being studied to further improve operational efficiencies and working capital. As informed in earlier call, to bring cost efficiency, two co-generation projects in UAE plants have been planned, investing approximately 45 million dirhams. Overhead cost control and productivity initiatives will continue. Lastly, to improve revenue and strengthen wholesale verticals, we are enhancing relationships with dealers and increase dealers' network. We have added new dealers in India and Africa, and [all over the] markets.

As you can see, we are making good progress on the 2017 priorities. Looking at the opportunities ahead, finding the right balance between organic growth and returning capital to shareholders will be a delicate act, but we are privileged to be in a strong financial position and are confident to achieve. With this, I would like to turn the call over to the operator and open the line to questions. Thank you once again.

[00:24:44]
[silence]
[00:24:57]
Abdallah: Operator?

Operator: Thank you. Ladies and gentlemen, we will now start our question and answer session. If you wish to ask a question, please press 01 on your telephone keypad. Thank you for holding until we have our first question. Our first question comes from Mahmood Akbar, AlRajhi Alpha Investments. Please, go ahead.

Mahmood: Hi. This is Mahmood. I have a question regarding the ceramic market internationally. If you look to international market saying, "Which is the most profitable ceramic company?" it's not in India. And this is like you mentioned in the presentation, part of your strategic initiative. Could you tell us what's going on in India? Is it like a country factor, is it an industry factor, or is it companies there are good? What's the story? I mean, [why is the Indian market different] than the... I understand that their consumption per capita is one of the lowest in the world versus Saudi, one of the highest. But is there any other things we're missing?   Thank you.

Abdallah: Thank you, Mahmood, for your question. As you mentioned, India's [very important] market is growing. The consumption per capita [is still low.] Now, on the profitability front, I don't think [the best] profitability [is there.] [But in terms of market cap of the] companies in India is highly valued. As far as India, the major players, we are almost the major players. But like Kajaria, Somany and others, they followed like four, five years back, the strategy of acquiring stake in Morbi or in places where the cost of production is cheap and in an unorganized sector, sourcing, branded, and using the leverage of their branding by distributing all over India.

That's why we also started two years back with sourcing our 50% from morbi Our revenue in India is coming from outsourced material, which we are growing. We can see that there is a pressure on the products sold from our factory due to the high costs and the transportation costs we have from in South India compared to all over India. Meanwhile, now we are also going onto the same route, and we are almost closing the first deal in acquiring a factory in

Morbi and Gujarat.

Mahmood: Yeah. But my definition of a profitability is a return on invested capital, and Kajaria and Somany have one of the highest return invested capital in the ceramics space. That's what I meant, and I think what you mentioned is the access to cheap labor and cheap [inaudible 00:28:25] may be the source for this profitability.

Abdallah: Mahmood, we know it very well. That's why if you see our market cap in Bangladesh, then you see during this quarter we sold 2% [at] 21.7 times earnings per share. And our strategy in India is the same. We have a very good brand perception. We are well-positioned in India. Our problem is that our capacity is small and only on the South. Finally, we get the approval of the Board, and now we are going, hopefully, to acquire stakes in more than one factory in India. And therefore, eventually, we will be...India is a very good market to be listed at.

Mahmood: So thank you. Thank you very much.

Abdallah: Thank you.

Operator: Ladies and gentlemen, as a reminder, if you have any further questions, please press 01 on your telephone keypad. Thank you for holding. Our next question comes from Anoop Fernandes, SICO Bahrain. Please, go ahead.

Anoop: Yeah. Good afternoon, gentlemen, and congrats on a good quarter. Regarding your Indian acquisition JV, could you please give us a sense of what the transaction value would be? I mean, what sort of enterprise value are we talking about and so on? Secondly, you mentioned that the capacity addition in tiles will be about 10 million square meters. Is this attributable, or is this the total capacity of the company that we're entering into JV with? Secondly, will there be an addition to sanitaryware capacity as well?

Abdallah: Anoop, thank you very much for your question. And [inaudible 00:30:39] long time, we are speaking about the Indian acquisition, but I can tell you that already we did the due diligence and we are starting looking off many factories. The target is 10 million square meters. Our existing capacity now in India is 8 million square meters in our plants. By acquiring 51%, we are expecting the total investment will be around $10 to $15 million. As you say, how will we finance it, as we mentioned the 2% of shares which we sold in Bangladesh will give us $7 million, which we'll use it to finance the acquisition in India. Regarding the sanitaryware, no. We are not searching for the time being, as the bulk is the tiles where we're concentrating on the ceramics now in India.

Anoop: Okay. After we get into the JV, will the product be sold under the RAK brand, or how will it work?

Abdallah: Yes, as we'll have equity there. We have control on the quality and the product, and the reliability of the supply. Then, it will be branded, sold to RAK Ceramics, and RAK Ceramics will distribute under our name in India.

Anoop: Okay. [I know.] But currently, we follow a model where we're outsourcing a large part of [our requirement] and, I mean, there was no real need for a JV. How do you see getting into a JV improving this arrangement? Why can't we have higher growth with the existing arrangement, instead of actually committing capital to a JV or to an acquisition?

Abdallah: Anoop, two things there. First, the reliability. You are working with an unorganized sector where you don't have the reliability. If someone was paying more, they would supply more. Maybe they would utilize your products, your design, and sell it off the market. So ideally, it is the best model which, earlier, Kajaria and other players followed to have control as you have a majority partnership in the factory. This is one , second as you said, the capital investment is not huge, visa vi, the opportunity which we have, as the first question from Mohamad came this thing in India is the multiple [given in] the market is something where it requires us to have an investment share.

Anoop: Okay. Now, from a valuation perspective, don't you think waiting for maybe a couple of months would have given you a better deal? Because clearly, I mean, the economy is slowing. We have a noticeable oversupply in the ceramics market. Isn't it...We're getting into this at a time where valuations are also at the peak? Or are you comfortable with the valuation right now?

Abdallah: Anoop, we are very comfortable and, you know, we've given the mandate to our local management, which they studied from all perspectives. And from us knowing acquiring 10 million square meters was $10 million to $15 million investment is not really something expensive in our standards.

Anoop: Okay. Thanks a lot.

Abdallah: You're welcome, Anoop.

Operator: Ladies and gentlemen, as a reminder, if you wish to ask a question, please press 01 on your telephone keypad. Ladies and gentlemen, I would like to remind you, if you have any further questions, please press 01 on your telephone keypad. We have no further questions. Dear speaker, back to you for the conclusion.

Abdallah: Thank you very much. Thank you, all.

Mohamad: Thank you, Abdallah. And thank you, everyone, for joining the call. Please have a nice day.

PK: Thank you, Haidar. Thank you.

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