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RAK Ceramics Q2 H1 Earnings Call and Webcast

Friday, August 9, 2024

Operator Welcome to the RAK Ceramics Q2 and H1 2024 Earnings Call and Webcast. My name is Felicia and I'll be your operator today. Following today's presentation there will be a Q&A session, you may register for questions by pressing star followed by one on your telephone keypad, if you have joined us on the telephone line. Or if you are streaming the call please use the Q&A box on the presentation site. I will now hand you over to your host today, Mohamad Haidar from Arqaam Capital, to begin. Please go ahead, Mohamad.

Mohamad Haidar Hello everyone, and welcome to the RAK Ceramics second quarter and first half of 2024 Earnings Call and Webcast. This is Mohamad Haidar from Arqaam Capital and from RAK Ceramics we are joined today by Mr Abdallah Massaad, Group CEO, and Mr PK Chand, Group CFO. Over to you, Abdallah.

Abdallah Massaad Thank you, Mohamad, good afternoon everyone and thank you for joining us today, welcome to RAK Ceramics second quarter 2024 Earning Conference Call and Webcast. As most of you are aware, our industry today faces many challenges given by ongoing geopolitical tension, which is creating uncertainty in the market, rising inflation and high interest cost is making borrowing expensive, which has reduced consumer spending and led to an overall slowdown in demand.

At RAK Ceramics, a substantial part of our revenue comes from export and we are facing several issues in these markets. The ongoing Red Sea crisis has led to rising trade costs and a shortage of shipping containers. Several are severely impacting our business, particularly in key export markets like the UK and Europe. Additionally, we also experienced a substantial increase in logistics costs for transporting products within the GCC. Since Saudi Arabia's imposing of customs duty on imports, increase in transportation costs, and shortage of trucks affecting our operation in the market, meanwhile in Bangladesh the issue of gas shortage and supply fluctuations has critically impacted our business. With the ongoing unrest in Bangladesh we expect further impact on our business in this market, that has traditionally been profitable for us.

Given all these challenges, we are focussed on strengthening our presence in the UAE, where we are fortunately not facing these issues. While we do see some pressure from the rising import of cheaper products from India we are concentrating our efforts on expanding our project and retail business in the UAE to ensure continued growth and stability. Now, let me take you through the consolidated revenue split for the group across our key markets, as well as the split between the product divisions.

UAE market continues to remain the largest contributor for the group total revenue and margins. This is followed by revenue from Europe, which contributes 23% of the consolidated revenue. Moving to the product segment, tiles division continues to contribute a majority share of the revenue followed by sanitaryware, faucets and then tableware.

Let me now take you through the financial performance across our core markets and product segments. While the UAE market experienced a nominal revenue decline, 1.2% year on year, mainly due to the holiday breaks for Ramadan and Eid falling in the same quarter and the impact of April floods, we remain optimistic about its growth potential. In Saudia Arabia, we are experiencing a revenue decline mainly due to an oversupply of low-cost products from local manufacturers, especially in tile segment. The ongoing regional conflicts have resulted in liquidity shortage, delaying many projects, and increasing the price sensitivity in the market.

Additionally, the levy of customs duty on imports, the logistics challenges, rising up the transportation costs and delay in delivery schedules, has put substantial pressure on our margin and business. However, we are pleased to inform you that we have recently received an exemption from the government from the payment of customs duties on

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import. This will provide some relief for our business as we remain committed to investing in and strengthening our project and retail presence in the retail.

The Red Sea crisis has led to a substantial impact on logistics costs both for import of raw material and export of product to Europe and to other markets. Additionally, since the European market continues to struggle with a slowdown in demand, we have seen many competitors reducing prices substantially, supported by the reduction in gas prices in Europe to curb the impact on their revenues. Decline in our revenue in Europe was mainly driven by our sanitaryware business in the UK, the recently imposed sanction against Russia by EU will also impact business overall since most of the players will push their product further in EU to reduce impact from decline in business in Far East.

We experienced a decline in revenue in Bangladesh, mainly driven by reduced demand and price liquidity. Additionally, fluctuation in gas supply continues to impact our production costs and reduce efficiency thereby impacting our margins. In India as well, the demand was slow due to increased interest rate and currency devaluation. Additionally, the national election for 2024 also contributed to an overall slowdown in demand as many government-funded projects went on hold. However, with election now over we anticipate a ramp up in project orders from Q3 onwards.

Within the tile segment we are experiencing an increase in the number of local players investing in tile globally. And also the market being flooded with imports from China and India, similarly for sanitaryware division we have seen companies globally lowering their price to combat falling sales volumes. Our tableware division maintains stable revenue despite an overall slowdown in demand due to the ongoing regional conflicts. We are pleased to inform you that we have completed the acquisition of the remaining 8% equity from the minority shareholders of RAK Porcelain, thus making it now wholly owned subsidiary of RAK Ceramics.

We are also happy to share RAK Porcelains entry into retail segment, with the launch of our first showroom in Dubai Hills Mall in UAE, and launch of our ecommerce website in the UAE market. We are optimistic about the growth potential of RAK Porcelain and will continue to roll out additional retail outlets in the future.

As we navigate these difficult market conditions driven by the rising instability and regional conflict we are dedicated to working closely to innovate our approach for staying ahead across all the markets. We are implementing several initiatives across our core markets. We continue toward brand enhancement through opening new showrooms and widening our dealer network in all core markets to strengthen and maintain our position. We are working closely with architects and designer communities to increase our network and promote our new collections.

We are focussing on premium products to mitigate the impact to our margins. We are also working on strengthening our retail and project business in our core markets, with differentiated products that will allow us to maintain a sustainable growth for revenue and margin going forward. We continue to invest in upgrading and expanding our production capabilities, allowing us to support markets with differentiated products. The upgradation of our five production facilities in India is completed, thus increasing our GVT tiles production capabilities for the market. In UAE, we have upgraded our tiles and sanitaryware plant with the latest technology and automation. We are also working toward setting up a production facility in Saudi for tiles. I will now hand over to PK Chand, our CFO.

PK Chand Thank you, Abdallah, good evening everyone and thank you for joining us. Mr Abdallah has already briefed on business performance highlights for key markets, challenges, and strategy update for the second quarter of 2024, I will take you through the financial highlights for the second quarter and first half of 2024, with details on revenue, gross profit margin and the balance sheet. We will start from slide 11.

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Total revenue in the second quarter decreased by 10.9% year on year to AED 777 million and in the first half of 2024 it decreased by 11.2% at AED1.56 billion, due to global geopolitical tensions, increased competition, market volatility, higher interest rate and currency devaluation. Tiles and sanitaryware revenue is lower by 13.2% year on year at AED 547.7 million, in the second quarter of this year and down by 13.8% at AED 1.10 billion in the first half of 2024.

Tiles revenue decreased by 13.4% year on year to AED 430.6 million in the second quarter of this year, while in the first half of 2024 it decreased by 14.2% at AED 874.2 million on account of lower volumes across all markets except the UAE. Sanitaryware revenue decreased by 12% year on year to AED 117.2 million, in the first half it decreased by 12.4% year on year at AED 229.9 million due to impact on volume across all core markets.

Tableware revenue remained stable year on year at AED 92.2 million in the second quarter of 2024, while in the first half it decreased by 4% at AED 182.1 million, mainly driven by decreased hotel projects and spending due to ongoing regional conflicts. Faucets revenue decreased by 6% year on year, AED 209.5 million in the second quarter, and in the first half of 2024 it remained stable with slight increase of 0.8% at AED 226.3 million. Revenue from other units decreased by 17.7% to AED 46 million in the first half of this year, mainly due to decrease in our ceramic raw material trading business, on lower production of tiles and sanitaryware.

Mr Abdallah has already covered divisional performance so now let me go through slide 14 onwards covering the segmental gross profit margins in the second quarter of 2024 and the first half of 2024. Total gross profit margin increased by 110 basis points year on year to 39.6% in the second quarter, an increase of 90 basis points year on year in the first half of 2024. Tiles margin in the second quarter increased by 10 basis points year on year at 39.2% and in the first half of 2024 it increased by 30 basis points year on year at 39.3%. Sanitaryware margin decreased by 200 basis points year on year at 32.9% and in the first half of 2024 it decreased by 410 basis points to 31.3% due to change in product mix and lower productivity.

Tableware margin increased by 130 basis points year on year to 52.5% in the second quarter, and in the first half of 2024 it increased by 240 basis points year on year at 53.1% following a change in product mix and supply of premium products. Faucets margin increased by 560 basis points at 30.7% in the second quarter and in the first half of 2024 it increased by 510 basis points year on year at 30.9% due to rationalisation of costs.

Net profit before tax for second quarter of this year is AED 59.8 million compared to AED 80 million in the last year, mainly due to decrease in revenue impacting 37.4 million to profitability. Margin is 7.7% compared to 9.2% in last year. Net profit before tax for this first half of 2024 is AED 133.7 million compared to AED 165.2 million in the last year, mainly due to decreased in revenue which has impacted AED 77 million to profitability. Margin is 8.6% compared to 9.4% in the last year.

Net profit after tax for the second quarter of this year is AED 51 million compared to AED 75.1 million in the last year. The impact of newly introduced UAE corporate tax at the rate of 9% effective 1st January 2024 is AED 6.4 million in the second quarter. The net profit margin is 6.6% compared to 8.6% in the last year. Net profit after tax for the first half of 2024 is AED 113.9 million compared to AED 155.3 million in the last year. The impact of the UAE corporate tax effective 1st January 2024 is AED 14.4 million in the first half of 2024. Net profit margin is 7.3% compared to 8.9% in last year.

EBITDA decreased year on year by 11.9% in the second quarter of this year to reach AED 136.9 million. The margin decreased by 200 basis points year on year to 17.6%. However, in the first half of 2024, EBITDA decreased by 7.9% at

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AED 288 million, while margin increased by 70 basis points year on year at 18.5%. Now we turn to balance sheet highlights on slide 16.

The overall working capital cycle increased from 172 days in December 2023 to 197 days in June 2024. Also, in absolute terms, working capital increased by AED 72 million to AED 1.56 billion in June 2024, mainly due to increase in raw material and dispersed inventory and payment to suppliers for purchase of fixed assets. The trades receivables increased from 90 days in December 2023 to 92 days in June 2024 due to lower LTM revenue. Inventory days increased from 221 days in December 2023 to 239 days in June 2024 due to increased raw material and dispersed inventory and lower LTM revenue. Trade payables increased from 59 days in December 2023 to 62 days in June 2024 due to lower LTM COGS.

Net debt increased by AED 132 million at AED 1.55 billion compared to December 2023 due to payment of dividend of AED 114.6 million, acquisition of remaining 8% stake in RAK Porcelain costing AED 44 million, and increased working capital. Net debt to EBITDA also increased from 2.2 times in December 2023 to 2.5 times in June 2024. We continue to maintain adequate liquidity position during the year. Capital expenditure during first half of 2024 is AED 97.3 million and the CAPEX guidance for the full year of 2024 is between AED 250 million to AED 300 million.

Slide 19 shows the share price movement during the last 12 months. The shares are currently trading at P/E multiple of 11.27 times, the board has approved to distribute interim cash dividend of AED 0.10 per share, representing AED 99.4 million to be paid to the shareholders. The current dividend policy, as approved by the shareholders, is to place the minimum dividend payout of AED 0.20 per share for the year 2024, to be paid on a semi-annual basis. Now I would request Mr Abdallah for his final comments before we answer your questions.

Abdallah Massaad Thank you, PK. It is evident that the ongoing geopolitical challenge and the crisis has in fact impacted businesses across industries. While we also have seen a decline in our overall revenue, we have been more fortunate than a few others in successfully restricting any major impact to our profit margin, mainly supported by the growth and business in the UAE market.

For me, going forward, I believe the relief of customs duty on RAX Ceramics in Saudi Arabia will support us in increasing our sales in Saudi. Saudi was always a main market for us and we are specified in many projects as well as we have our distribution entities, warehouses, and showrooms. And with now the relief for remove of customs we see a potential growth for us despite that the market is tough and it is today oversupplied by local factories, but we do believe with the differentiated brand and position which we have we will be able to sell more.

We continue to see more and more local factories coming up globally, focussing on supplying cheaper products in local markets. In this complex scenario we remain dedicated to serve our stakeholders as we continue to position ourself as a global preferred supplier with strong focus on quality and differentiated products. Lately we announced our upgradation of our NC5 [? 00:22:13] by putting the latest continuous press to produce the biggest or the largest tiles in the world from 1.8 metres to 3.6 metres, supporting the projects coming and also increasing our area of focus on tabletops and kitchen tops and also outside tile cladding.

We remain committed to protect our market share and solidifying our retail and project business through maintaining healthy competition and leveraging on cross-product synergies. Thank you all for taking the time to join us for this presentation of our Q2 results for 2024. I would now like to hand over the call to the operator and open the line to questions.

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Operator Thank you. If you wish to ask a question please press star followed by one on your telephone keypad if you are joining us via the telephone line. If you are joining us on the internet, on the right-hand side top of the presentation page you will find the Q&A box, which you may use to submit questions in writing. Our first question comes from Sameer Kattiparambil from EFG Hermes, please go ahead, your line is now open.

Sameer Kattiparambil Thank you, thanks gentlemen for the call and presentation. A couple of questions from myself, first on that customs duty cut, are you going to get back the paid amounts so far? So I just want to find, and how much you've paid so far in terms of the customs duty. So that's my first question. Second is on the Bangladesh operation, how is the current scenario looks like, how's that going to impact you in terms of sales and outlook in the Bangladesh market?

Abdallah Massaad Thank you, Sameer, for your question, of course we are very happy to finally get the customs duty relief and we are now even exempted on paying the tax on the border until October next year. So how it works, you prepare the documents for the six months and we get now accepted, these six months which we are working. And I believe what we will get back for sure is at least almost AED 6 million, for sure we'll be claiming for the amount which we paid earlier but this is not yet, we don't have any confirmation on this. So one we get the relief onwards and almost a AED 6 million which we've paid during this period.

Now, regarding Bangladesh, Bangladesh the last six months we are struggling with non-availability of gas, liquidity issues, and lately what happened last week honestly we were forced to stop the production with the country went difficult to operate. Honestly now with all these changes some of the people started coming to the office and also in terms of production we started again the factory. So we are hopeful that situation will get stabilised and we will go back to normal.

Sameer Kattiparambil Okay, Abdallah, that's clear. Just a follow up on that 6 million you mention, is that 6 million is what you've paid so far this year? That you're going to get back?

Abdallah Massaad Not the year. So how it works it is every six months you get, so we submitted our document, related documents, starting from April this year. So what we've paid from April until now is approximately AED 6 million, this for sure we will get it back. Now, from last week onwards we are not paying anymore, so for sure for the last weeks we've paid much more than this amount, this we are not sure if we will get it back or no. We are trying for sure but we don't have any confirmation on it.

Sameer Kattiparambil That's very clear, thank you so much, Abdallah.

Abdallah Massaad But honestly, we're very happy at least going forward we do not have this 12% to pay out.

Sameer Kattiparambil Yes, since the deduction of the amount you will get additional margin from that market, right, like 12%. Or does it mean a higher volume as well?

Abdallah Massaad It is for us for sure a higher volume, yes, even we'll not get the 12% fully but at least we can get a better margin than what we have today and a bigger volume. And today, as we discussed, and whatever is happening and you see the results it happened last during COVID when the transportation cost increased we cannot do anything, we have to increase our costs and the prices. So ideally, it's to sell locally or even by car or by road, which Saudi is the market which supported us during COVID.

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And unfortunately, for this time it was the customs duty. Now, with the relief of customs duty then we have the GCC market to support our revenue until honestly the export international market and Europe will be always affected. We can sell but then we will lose money, so that's why we are protecting the margin because we know we cannot do anything with the freight.

Sameer Kattiparambil Got it, thanks so much, Abdallah.

Abdallah Massaad Thank you, Sameer.

Operator As a reminder if you wish to ask a question please press star followed by one on your telephone keypad if you have joined us on the telephone line. For those of you on the internet, please use the Q&A box which can be found at the top-right side on the presentation page. We have a follow up question from Sameer Kattiparambil, Sameer your line is now open again.

Sameer Kattiparambil Thank you, two more questions from my side. You mentioned about the India upgrades production testing completed, could you remind me on how much CAPEX you first spent and what does this mean for volume? And also, on the UAE upgrade can you just let me know what's the current status for the UAE upgrade? Thank you, that's it.

Abdallah Massaad Sameer, you know we had in India three manufacturing places, so one of them was for ceramic, it was called Gris Ceramics which we owned 51%. And with the decline in demand in ceramics we upgraded this line of the existing plant, so we removed the old scale. What we invested is almost AED 15 million approximately. So this will give us almost 5 million square metres of GVT glaze with revitalised porcelain tiles in a bigger size.

Now, in UAE we started upgrading our continuous, in 2012 we were putting one of the... Beginning the factory in the world producing largest slabs. So we are adding today the latest version of the press which produces the biggest tiles with all the finishes. And again, with a bigger kiln this will take us another six months, plus or minus, we will be ready to manufacture.

Sameer Kattiparambil Okay, thank you so much.

Operator We have received a text question. Is the exemption received in Saudi for customs duty very specific to RAK Ceramics and also is it a conditional exemption?

Abdallah Massaad Thank you for the question, yes it is actually granted for RAK Ceramics because we complied with all the requirements. There is no... Well conditional, it is not a conditional it is a six months, every six months we have to update our documents and submit it.

Operator Thank you. As a reminder, please press star followed by one on your telephone keypad to ask a question. Or submit your question in writing using the Q&A box on the presentation site.

Mohamad Haider Felicia, until we get a question I have a few from my side. So Abdallah, so this tax release is granted until October 2024, six months from April, and if you think it's going to continue in the coming periods would you still pursue the plan with establishing a factory in Saudi or you think it's no longer viable if you get exemptions in the future to have an actual plant?

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Abdallah Massaad Well, Mohamad, thank you for your question. Look, we do believe that with the documents we submitted and get it audited it is complying with all what the authorities is asking. And I believe while we get it for at least starting from now I don't see any reason why we don't get it further going forward. And as I mentioned now also we try to claim the earlier payments if possible.

Now, regarding the Saudi plant, Mohamad, for us Saudi is considered to be our local market and being in Saudi, having a factory in Saudi, will support our sales and presence. So this will not cannibalise our sales or what we are doing out of UAE. Yes, even though we got the relief the moment we get a clarity and the guide and all the requirements to set up a factory we will proceed.

Mohamad Haidar Very clear, Abdallah, thank you.

Abdallah Massaad Thank you.

Operator As a final reminder, if you wish to ask a question please press star followed by one on your telephone keypad or use the Q&A box on the presentation page. I think we have no further questions so I'll hand back to the management team for any closing remarks.

Abdallah Massaad Thank you very much, thank you for your time.

Mohamad Haidar Thank you, Abdallah, PK Chand, and everyone who joined today, thank you Felicia, and we look forward to having you with us next quarter. Have a nice day.

Abdallah Massaad Thank you very much.

Operator Thank you everyone, this concludes today's call, you may now disconnect your line.