Transcript

RAK Ceramics Q3 and 9 Months 2024 earnings

Wednesday, November 13, 2024

Operator Hello, everyone, and welcome to today's RAK Ceramics Q3 and nine month, 2024 earnings call and webcast. My name is Seth, and I'll be the operator for your call today. If you would like to ask a question during the Q&A session, you can press star one on your telephone keypad. Or, if you're listening to the call via the web browser, you can type a written question using the Q&A chat box in the top right-hand corner of your screen.

I will now hand over to Mohamed Haidar from Arqaam Capital to begin. Please go ahead when you're ready.

Mohamad Haidar Hello, everyone, and welcome to the RAK Ceramics third quarter, nine months of 2024 earnings call and webcast. This is Mohamad Haidar from Arqaam Capital and we are joined today, from RAK Ceramics, by Mr Abdallah Massaad, Group CEO, and Mr PK Chand, Group CFO. Over to you, Mr Abdallah.

Abdallah Massaad Thank you, Mohamad. Good afternoon, everyone, and thank you for joining us today. Welcome to RAK Ceramics' third quarter 2024 earnings conference call and webcast. The global economy continues to remain challenged by the ongoing geopolitical tensions, inflationary trends, and complex supply chain disruption, which are particularly affecting export-driven industries like ours.

The Red Sea crisis continues to push the freight cost upwards, thus affecting our margins, particularly in key export markets. Additionally, we also experienced a substantial increase in logistics costs for transporting products within the ECP. However, the recent interest rate cut, along with expected future cuts, will improve the overall liquidity. This may ease credit conditions and stimulate real estate sectors, which will support our business.

Let me now take you through the consolidated revenue split for the Group across our key markets, as well as the split between the product divisions.

The UAE market continues to remain the largest contributor for the Group's total revenue and margins. This is followed by revenue from Europe, which contributes 23% of the consolidated revenue, followed by India and Saudi Arabia.

Moving to the product segments, Tiles division continues to contribute majority shares of the revenue, followed by Sanitaryware, Faucets and then the Tableware.

I will now take you through the financial performance across our core markets and product segments. The UAE market remains resilient, supported by growth and real estate and construction sectors. In Saudi Arabia, competition and oversupply in the market has led to a decline in revenue. The rising transportation cost also continues to remain a challenge for us, but we were able to sustain our margins, supported by the relief from customs duty on our export and change in product mix.

The European and the UK markets continue to face inflationary pressures, recessionary conditions and heightened competition. The recent rate cuts may provide some relief, but demand continues to remain low. Also, the rising freight costs and logistical challenges further create pressure on our operations in Europe.

While the Indian market has shown resilience, despite the macro challenges, it also faces severe competition from domestic manufacturers due to lower exports from India, leading to a highly price-sensitive environment locally. As you know, the increase in freight, as I mentioned, is impacting all the industries where it is export based, especially from East to West, and therefore also the ceramics industry in India has been badly affected by the increase in freight, and thus they focussed on reducing the price and competing in the market in order to sell locally.

Our business in Bangladesh saw a drastic impact due to the political instability, gas shortages and currency devaluation. This also impacted production efficiency and cost, along with revenue and margin, leading to losses. For the Tiles Division...

Operator I'm sorry, we have lost connection with the speaker line. Please stand by whilst we re-establish connection. The call will resume shortly. Thank you for your patience. You may resume the call now.

Abdallah Massaad Sorry for the line cut. For the Tiles Division, revenue declined across most markets, except the UAE, where we achieved positive growth, supported by growth in construction and real estate sectors. Our focus on maintaining pricing discipline rather than engaging in price wars has helped us maintain our margin.

In the Sanitaryware and Faucets Divisions we faced headwinds in most of our export markets due to the higher freight costs and logistic challenges. Business was also impacted due to the decline of real estate sector in China, and with the new sanctions levy in Russia.

Our Tableware Division saw a decline in both revenue and volume, largely due to the slowdown in the hospitality sector and supply chain disruption driven by regional geopolitical tensions. As we navigate an increasingly complex global environment, I would also want to discuss the primary challenges we are encountering in our core markets and the focussed strategies we are implementing to strengthen our position and drive a long-term growth.

In the United Arab Emirates, where the influx of lower cost imports is rising, supported by the free trade agreements, our strategy remains to strengthen our partnerships with reputable developers across the UAE, supplying them with our tiles, sanitaryware and faucets for their projects, as well as improving our specification team, working with a designer, architect and developer to provide solutions for their projects. I believe with our reliability, the good quality and the innovation with our R&D team focusing on solution, and even despite all the competition we are facing, we saw an increase in sales in the UAE market, and especially in the project market which is going on.

In Saudi Arabia, the oversupply of tiles from local manufacturers, combined with increased transportation costs for exports from the United Arab Emirates, has challenged our position in the wholesale market. However, the recent government exemption on custom duties for imports has provided some relief, helping us to offset costs and improve our competitiveness.

Additionally, we are also focusing on introducing premium products to support our retail and project channels, which allows us to maintain margins and avoid engaging in price wars. I believe also, in Saudi, with now the premium projects in pipeline, this will be a good potential for a company with a branded product as well as innovative products, to get a reasonable market share.

Europe remains a challenging market, with recent economic pressures driving lower demand. However, we are working closely with the architect and designers' community to increase our network and promote our new collection. As we mentioned, we have our design centre in the UK. We opened a new design centre in Germany, in Frankfurt, and now we are working. We already took a showroom in Milan, where we will be opening by the first half of next year, focusing on working closely with architects and designers in order to get specified in a global level.

India continues to remain a very price-sensitive market, and to address this we are working on strengthening our retail presence and enhancing the in-store experience to drive higher engagement with customers. By providing a differentiated shopping experience, we can attract quality focussed consumers helping to build a stronger market position.

Lastly, in Bangladesh, political instability, currency devaluation and a shortage of gas continue to affect the market. Our focus here is to establish a strong distribution network that can reliably deliver high quality products supported by innovative solution to stand out from the competition. We also continue to work towards brand enhancement through opening new showrooms and widening our dealer network in all the markets.

In the UAE, we continue to invest in both our production facilities and our retail presence. In our Tiles Division we are upgrading production capabilities with the latest technologies to produce differentiated, large-format tiles that will meet the growing demand in high-end markets. We are working to put a new Continua Plus where we can go up to the largest format, as well as converting part of our ceramics lines to a porcelain line, where we saw a big shift in the demand in porcelain and we are upgrading our facilities in order to keep up with the demand in this sector.

In our sanitaryware facilities we are investing in the latest technologies that will help us reduce both carbon emissions and energy consumption, aligning with our sustainability goals. Our newly opened showroom in Sheikh Zayed Road in Dubai showcased the RAK Ceramics Lifestyle Concepts, featuring displays that allow customers to experience our product in the real-world setting.

Also the same in terms of tableware with the showroom. We opened it in Dubai Hills Mall where, for the launching of our retail focus tableware, it is giving a good positioning to the brand.

In Saudi Arabia we are actively progressing towards establishing a new production facility for tiles, which will strengthen our local presence. I'm also pleased to share that RAK Ceramics was recently honoured as the UAE Industry 4.0 leader by the Ministry of Industry and Advanced Technology, recognising our digital transformation effort within the industrial sector.

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

PK Chand Thank you, Abdallah. Good afternoon, everyone, and thank you for joining us. Mr Abdallah has already covered the key market performance highlights, challenges and strategy updates for the third quarter of 2024. I will walk you through the financial highlights for the third quarter and nine months of 2024, including details on revenue, gross profit margin and the balance sheet items. We will start from slide 11.

Total revenue in the third quarter decreased by 4.1% year on year at AED 802.5 million, and in the nine months it decreased by 8.9% at AED 2.36 billion due to continued global geopolitical tensions, inflationary trends and complex supply chain disruptions, which are particularly affecting export-driven industries like ours. However, total revenue increased by 3.3% quarter on quarter, supported by growth in all markets, except Bangladesh and European markets.

Tiles and Sanitaryware revenue is lower by 2.21% year on year, at AED 585.7 million in the third quarter, and by 10.1% to AED 1.69 billion in the nine months. Tiles revenue decreased by 1.5% year on year to AED 468.2 million in the third quarter, and in nine months it decreased by 10.1% to AED 1.34 billion on account of lower volumes across all markets, except the UAE.

Sanitaryware revenue decreased by 4.5% year on year to AED 117.5 million in the third quarter, and in nine months it decreased by 9.9% year on year at AED 347.5 million due to impact on volume across all core markets.

Tableware revenue decreased by 7.8% year on year to AED 85.3 million in the third quarter, and in nine months it decreased by 5.2% to AED 267.4 million, mainly due to slowdown in the hospitality sector and supply chain disruption driven by regional geopolitical tensions.

Faucets' revenue decreased by 5.3% year on year to AED 108.8 million in the third quarter, and in nine months it decreased by 2.3% to AED 335.1 million as we continue to face headwinds in most of our export markets due to higher freight costs and logistical challenges. Business was also impacted due to decline of the real estate sector in China, and with new sanctions levied on Russia. Revenue from other units decreased by 21.1% to AED 68.8 million in nine months, mainly due to a decrease in our ceramic raw material trading business on lower production of tiles and sanitaryware.

Mr Abdallah has already covered the regional performance, so I will move to slide 14 onwards, covering the segmental gross profit margins in the third quarter and nine months of 2024. Total gross profit margin increased by 250 basis points year on year to 41.2% in the third quarter, an increase of 140 basis points year on year at 40.0% in the nine month period due to change in overall product mix in most of the markets.

Tiles margin in the third quarter increased by 350 basis points year on year at 42.5% to an all-time high, and in nine months it increased by 140 basis points year on year at 40.4%, supported by a shift in production mix from ceramics to GP tiles and better efficiencies.

Sanitaryware margin increased by 200 basis points year on year at 33.8% in the third quarter, while in the nine month period it decreased by 210 basis points year on year to 32.2% due to change in product mix and lower productivity.

Tableware margin increased by 270 basis points year on year to 52.7% in the third quarter, and in nine months it increased by 250 basis points year on year at 53%, following a change in product mix and supply of premium products.

Faucets' margin also decreased by 360 basis points at 28.9% in the third quarter due to lower revenue. However, in nine months it increased by 220 basis points year on year at 30.2% due to rationalisation of costs.

Profit before tax for the third quarter is AED 60.8 million compared to AED 91.9 million in the last year. Profit decreased mainly due to lower revenue, lower other income, higher impairment loss and newly introduced UAE corporate tax. Profit margin is 7.6% compared to 11% last year. Net profit before tax for nine months is AED 194.6 million compared to AED 257.1 million last year. Profit decreased, mainly due to lower revenue, lower other income and UAE corporate tax.

Factors impacting the profit from nine months of 2023 to 2024 are given in slide 15. Profit margin is 8.2% compared to 9.9% last year. Net profit after tax for the third quarter is AED 55.9 million, compared to AED 83.9 million last year. The impact of the newly introduced UAE corporate tax at the rate of 9% effective 1 January 2024 is AED 7.9 million in the third quarter of this year. Net profit margin is 7% compared to 10% last year. Net profit after tax for nine months is AED 169.9 million compared to AED 239.1 million in the last year. The impact of the newly-introduced corporate tax is AED 22.3 million in nine months.

Net profit margin is 7.2% compared to 9.2% last year. EBITDA decreased year on year by 13.5% in the third quarter to AED 146.2 million. The margin decreased by 200 basis points year on year to 18.2%. In nine months the EBITDA decreased by 9.3% at AED 434.2 million, and margin decreased by 20 basis points year on year at 18.4%.

Now we turn to balance sheet highlights on slide 16. Overall, working capital cycle decreased from 197 days in the second quarter of 2024 to 196 days in the third quarter 2024. Also, in absolute terms working capital decreased by AED 17 million to AED 1.54 billion at the end of third quarter 2024, mainly due to increase in payables.

Trade receivables increased from 92 days in June 2024 to 94 days in September 2024 due to higher quarter on quarter revenue by 3.3%. Inventory days increased from 239 days to 254 days quarter on quarter due to increase in raw materials and stores inventories. Trade payables increased from 62 days in quarter two 2024 to 66 days in the third quarter 2024, due to lower LTM cost of goods sold. Net debt increased by AED 14 million to AED 1.57 billion compared to June 2024.

Net debt to EBITDA also increased from 2.50 times in June 2024 to 2.61 times in September 2024, mainly due to lower LTM EBITDA. We continue to maintain adequate liquidity position during the year. Capital expenditure during nine months of this year has been AED 132.5 million. Capex guidance for the full year of 2024 is revised to AED 225 million.

Slide 19 shows the share price movement during the last 12 months. The shares are currently trading at PE multiple of 11 times. Now I will turn back to Mr Abdallah for his final comments before we answer your questions.

Abdallah Massaad Thank you, PK. It's evident that the ongoing geopolitical challenges and crises have impacted businesses across industries. While we witnessed the resilient performance in the UAE, backed by growth in the real estate sectors and rising tourism, our revenue in other core markets was impacted. However, we have been more fortunate than a few others in the industry in successfully restricting any major impact to our profit margin.

We will continue to make strategic advances in our core market, driven by a clear focus on quality innovation and sustainability as we see more and more local factories coming up globally, focusing on supplying cheaper products in the local markets. In this complex scenario, we remain dedicated to serve our stakeholders as we continue to positioning ourselves as a global preferred supplier with a strong focus on quality and differentiated product offering.

Thank you all for taking time to join us for this presentation and our Q3 results for 2024. I would like now to hand over to the operator.

Operator Thank you. If you would like to ask a question, please press star one on your telephone keypad. If you would like to withdraw your question, please press star two. If you are listening to the call via the web presentation, please type your question in the Q&A box located in the top right-hand corner of the screen. We will just pause briefly while we take your questions. We have an audio question on the line from Nikhil Mishra at Al Ramz. Please go ahead.

Nikhil Mishra Hi. Thank you for the presentation and taking the questions. A couple of questions from my side. First of all, what is the progress on the Saudi plant? Is there any update on securing gas supply there? And is the change in the Capex guidance related to that particular plant? The second question is on the land parcel in Ras Al Khaimah. Any update on the sale of that land parcel or any progress there? Thank you.

Abdallah Massaad Thank you for your question. As we always mention, Saudi is a very important market for us and, honestly, now with the custom duty relief, you see that the Company and the sales has improved and the margin also improved for us in Saudi. We are continuing following. Honestly, we are waiting. At least now we have the gas allocation but we don't have the time commitment from Marafiq and hopefully that we are following. I think personally that before the end of the year we should be able to know when the gas will be given and, accordingly, we will update the market whenever we have any information.

Regarding the Capex for this year, no, because I don't think something is there but the moment we will get, as you said, the gas allocation and the timing where we get the gas, we will, with the announcement of the project, give the Capex guidance in that.

Regarding the land, no, unfortunately, until now I believe, as you said, many projects are going on and, as on today, we don't have any updates regarding the land which we have there.

Nikhil Mishna Thank you, I have just one more question, if I may. Around a month back you announced a framework agreement with Sobha. So, I just wanted to understand what is the potential business that could come from that particular agreement and what is the scope of that agreement? And also, will you be looking to have such more agreements with more developers going forward?

Abdallah Massaad Look, it is not the first time we do such an agreement. Before, with Azizi we have. We have a framework agreement with Emaar and with many developers and we are working, as I mentioned, with most of the known developers. Look, what affected us badly in the logistics also gave us some advantage locally because other suppliers which are coming also from outside, they will have the issue of logistics and timing and uncertainty.

For us, as RAK Ceramics, a branded product, a global product, all these developers and contractors, they prefer to work with us as we are reliable, giving a good quality product. Now, what is the potential? You see, the trade in our projects in the UAE this year is almost up by 18%. So, we are gaining more and more projects and we'll have, for sure, a higher potential of increasing our market share and improving our sales daily. I hope I answered you.

Operator Thank you. We did lose connection with Nikhil, so we can just move on to the next question. On the tech side of things, we have a question from Dina Hicham from EFG Hermes. Despite the cost rationalisation, Faucets margins is lowest during third quarter 2024 at 29% versus 32% last year. What leads to the decline? And customs duty relief in KSA you mentioned in the presentation. Could you elaborate more? Can we expect full repayment of duty you paid over the last two years?

Abdallah Massaad Regarding the first thing, regarding Faucets, unfortunately when we filed KLUDI, after two months it was announced the war happening with Russia and Ukraine and KLUDI as a company was strong in East Europe because we had factories in Austria and Hungary and before in Poland. So, it was having a good market. And this market was with a good margin. So, year by year this was impacted.

Also the China subsidiary of KLUDI also had a good sale in China as well as a good market but, unfortunately, some bankruptcies happened to a big player in the real estate sector. This impacted the sales with a big margin. So, what remained in Europe was the white label. And we are in the process of restructuring, manufacturing, relocation plans. This is temporary. I believe the margin will see improvement next year and the year after where we believe that in 2026 we'll finish all the relocation manufacturing footprint and therefore it will give a positive impact in the margin.

Now, regarding the custom duties, as we said, after a lot of follow-up, and I believe we are among the few, if not the first, company who get this exemption in customs, we started it starting April last year. We already got a refund. How much, PK, until now?

PK Chand The exemption is around AED 10 million.

Abdallah Massaad Around AED 10 million. And, honestly, we are happy to see that after the six months gone, because exemption will be for six months, also we got now the exemption for the next six months. So, this is, I believe... Regarding the payment, which we have done it before, we are trying our best but until now what we get exemption is starting April until now.

Operator Thank you. And then the next two questions from Dina were, how big is the loss in Bangladesh, what's the current status there and when are you expecting a turnaround? How is the new China stimulus package, including the export subsidies, going to impact the Tile and Sanitaryware segments in the MENA region? Can we expect a significant level of export to the MENA region?

Abdallah Massaad Look, let me answer first Bangladesh. In Bangladesh, this company, RAK Bangladesh, was always really doing extremely good since the beginning and it was forever a profit-making entity. Unfortunately, with the last few years, at least two years, I believe, was pressure on inflation, on the currency devaluation, on non-availability of dollars and the non-availability of gas supply. Last quarter, with all this disturbance that happened and changing of government, we had a loss of AED 4.9 million in the third quarter.

What we see that I can say now, that the supply of gas recently, we came back to almost getting back what is the requirement in the factory. Therefore we increased the capacity and the factory utilisation. I believe that the business now, it's stable and going back to a stabilisation. It is premature to assess what will happen, how it moves. But as we see an improvement has happened, and we are monitoring the situation going forward. The second one is...?

Operator Sorry, I'll just repeat the next question.

Abdallah Massaad Yes.

Operator So, the next one is, how is the new China stimulus package, including the export subsidies, going to impact the Tile and Sanitaryware segments in the MENA region? Can we expect a significant level of export to the MENA region?

Abdallah Massaad Honestly speaking, we don't take it into consideration, because where is our position as a Company and what we sell and the price level we are in and the Chinese manufacturers are, we are not competing as the same segments. So, honestly speaking, I don't see any impact on us because we are not in in competition in the same segments here.

Operator Thank you. I'll move on to the next question from Wei Chow at Al Rayan Investments. Why has selling and distribution increased in third quarter despite lower revenue year on year? What is the trend we should expect going forward?

PK Chand If you go to the Schedule 8 on the financial statements, the schedule is very clear. One is staff expenses have gone up because we recruited more people for sales. The second is the freight and transportation expenses, which, as Mr Abdallah already pointed out, there is a significant increase in the transportation expenses post the Red Sea issue.

And the third is we incurred more advertisement expenses. So, compared to last year, AED 60.6 million, this year it is AED 20.7 million. So, these are the three main heads because of which the expenses have increased. The question how we can see going forward, freight and transportation, what we have seen, it started coming down slowly. So, the increase has stopped now. So, that is what we have seen. Now, advertisement, depending on the requirements, we will continue to do the advertisement expenses.

Operator Thank you. Just a reminder, for any further questions please press star one on your telephone keypad, or type your written question in the Q&A chat box in the top right-hand corner of the presentation screen.

Mohamad Haidar Hi, this is Mohamad Haidar, Abdallah. It's really impressive, the growth level is going up despite the lower sales or revenues. Hypothetically speaking, if you manage to pick up sales in the coming years, can we also expect margins to grow further, higher than 41%/42%?

Abdallah Massaad Mohamad, thank you for your question. If you look at the peers and check our peers globally and you see the margin and the impact, there was two directions. One direction is the demand is lower globally, all the challenges we have. So, some of the groups reduce their prices and therefore maybe they didn't have a dip in the revenue much. But we can see that they went either into negative net profit or a very, very low, negligible margin.

So, as a Group, as a Company, we decided that we understand the geopolitical and the inflation and the recession worldwide. So, we took the other direction on improving our margin, on improving efficiencies, and we understand that we will lose some volume but let us maintain the margin. I believe the margin which we are in today is very healthy. Going forward, can we improve it further? It's premature. We don't know how the market moves but I don't see a big difference on where it can go on the other direction. But I'm hopeful, for sure, that whatever there will be, at least the transport, the freight, the logistics, will improve, our revenue will improve, and therefore this will give us a different direction.

Mohamad Haidar Understood. And, Abdallah, when you say if freight rates improve, sales go up, is this your decision to export more out of the UAE?

Abdallah Massaad No, but always historically, even today, the UAE is our biggest market. But even with the biggest market, our sales to the UAE does not cross the 35%. Europe is a big market for us. All the world in terms of export projects. So, we cannot sell all our capacity in UAE. We have to export it. And today, with the logistics increased in a big way, so it's not a small increase, plus the timing, crossing the Red Sea, is giving a big impact on really people who want to import our products.

Therefore, we are, yes, impacted in profitability as well as the volume. Because today selling a product going to USA has gone up from 3,000 to almost 8,000/9,000. So, the increase for the product which we sell represents a big disadvantage on us. So, therefore, this is the main impact in revenue coming from everywhere, including Europe and all the export markets. That's why we focussed on the UAE and the GCC. So, we'll have at least a better net profit, if you want to see contribution.

Mohamad Haidar Understood. And, lastly, so you have agreements in the UAE with Emaar and other developers. Are there similar agreements in Saudi, or are you working on similar agreements there with big developers?

Abdallah Massaad Yes. So, that's why we see that we have done in Saudi a lot of... Our project specification team is doing really a good job and we saw that we are having a good lead. Earlier it was mainly the housing project which we are in, but in this case, what is our target is going into the big projects, differentiated projects, where this is what I mentioned I believe will have a bigger market share in the high end projects.

Mohamad Haidar Excellent. Thank you very much.

Abdallah Massaad Thank you, Mohamad.

Operator And currently, we have no other questions on the conference call.

Abdallah Massaad Thank you. Thank you very much for attending and thank you, Mohamad.

Mohamad Haidar Thank you, Abdallah and PK Chand and everyone for joining. Looking forward for our next call next quarter. Have a nice day.

PK Chand Thank you.

Abdallah Massaad Thank you.

Operator This concludes today's conference call. Thank you all very much for joining.