

Company: QNB Financial Services Co. WLL
Conference Title: Baladna (BLDN) Q2 2022 Results Conference Call
Moderator: Phibion Makuwerere
Date: Wednesday, 17 August 2022
Conference Time: 11:30 (UTC+00:00)

Phibion Makuwerere Good afternoon. Thank you all for joining us for Baladna's 2Q 2022 Conference Call. My name is Phibion from QNB Financial Services. On today's call, we have Baladna's management team, the CFO, Saifullah Khan, and the Investor Relations Officer, Upendra Jayamaha. They will go over the performance and we have a question-and-answer session immediately afterward. It's over to you, Saifullah and Upendra.

Saifullah Khan: Thank you, Phibion. Good afternoon, ladies and gentlemen. I would like to welcome all of you to the earnings conference call of Baladna, for the second quarter of 2022. My name is Saifullah Khan, as Phibion mentioned, I am the CFO for Baladna. With me, I have Baladna's Investor Relations Officer, Upendra, and the reporting team from Baladna. During this earnings conference, I will provide you with an update on our operational and financial performance for the quarter. For additional details, please refer to our investor presentation, which is published on our website, in case you have not already received it.

To start our presentation, during the second quarter of 2022, Baladna achieved revenue of QAR 245 million and a net profit of QAR 22 million. This represents revenue growth of 23% compared to the same period of last year and a decline of 49% in terms of net profit. Baladna displayed its resilience by mitigating a challenging macroeconomic environment by increasing sales volumes through capturing a greater market share across the majority of the product lines.

However, our cost of sales, especially material costs, increased significantly as a result of higher global commodity prices, which impacted our profitability, considering we have not yet increased our selling prices. As we announced in our previous call, we have submitted a proposal to the Ministry, and as of today, we are still awaiting for the approval. We expect that our profitability will be back to the historical range going forward, once the Ministry approves the selling price increase. Most of the regional peers have already increased their selling prices by two to three times in the recent past, which we have witnessed. In terms of our operations, Baladna enhanced operational efficiency, in particular managing its herd, which resulted in a higher milk yield per cow of 38.4 liters per day in Q2 2022, compared to 38.2 liters per day in Q2 2021. Additionally, efficiencies in the manufacturing process, reduction in service costs, improvements in control and systems, as well as overhead cost control contributed to maintaining healthy margins.

Optimization of the product portfolio through the introduction of value accretive products and de-listing lower performing SKUs remains a key strategic pillar for Baladna's growth. We decreased our total SKUs to 246 as of the end of Q2 2022 by de-listing lower-performing products. Additionally, Baladna managed to increase its total market share across the majority of product lines. Baladna's aim is to continue its product innovation and introduce new products throughout the rest of the year to capture greater market share. For more details, please, you are requested to view the operational performance section of the investor presentation, which we already shared with you.

Moving to Baladna's Financial Performance, while macroeconomic challenges, including rising global commodity prices and inflation, dominated the retail sphere, Baladna achieved a revenue of QAR 484 million in the first half of 2022,

which represents a 27% growth compared to last year. Net profit for the first half of the year was QAR 48 million, which represents a decline of 45% compared to the same period of last year.

The increase in our revenues was primarily driven by increasing market share across all product categories, with the exception to one category, which is Labneh. As I mentioned earlier, increases in global commodity prices, especially feed, which is a major component of our cost, raw materials, ingredients and packaging materials, significantly impacted our profitability, considering that we have not yet increased our selling prices.

Similar trends continued in the second quarter compared to the first quarter of the current year, as we have increased our top line, but the bottom line is impacted due to high commodity prices. In terms of numbers for the second quarter of the year, Baladna recorded a revenue of QAR 245 million, which represents a growth of 23%, and a net profit of QAR 22 million, which declined by 49% compared to last year.

In terms of growth by channels as highlighted in slide number 20, horeca channels grew by 45% compared to last year, by attracting strategic customers and introducing long-term contracts. Retail modern trade and traditional trade also witnessed a good growth of 24% and 17% respectively. Baladna continues to improve existing client relationships while targeting new customers. Moving forward to the presentation, our share investment portfolio reached QAR 210 million from QAR 144 million by June 2022. For more details, please refer to the financial performance section of the investor presentation.

Baladna is continuously assessing potential value accretive opportunities for expansions. Progress was achieved with the Malaysia dairy project, we recently announced that it has entered into a shareholder agreement to develop our integrated dairy farming business. The project is expected to be commercially operational by 2025. The facility will have the capacity to produce 100 million liters of fresh milk annually within the first three years and is expected to reach 300 million liters of fresh milk within ten years.

Additionally, I would like to give you a quick update on the evaporated factory, which we had previously announced last year. The project is progressing well and is expected to become operational by early 2023. Furthermore, Baladna has a strong pipeline of new SKUs to be launched and is expected to come to the market during the second half of 2022. If you look towards the remainder of 2022, we expected the retail market to gain momentum, and management plans on implementing new initiatives to capitalize on improving market dynamics.

Furthermore, with the scheduled 2022 FIFA World Cup, we are expecting a robust revenue growth in the second half of 2022, and we are ready to explore further opportunities across retail and horeca channels to further enhance our product portfolio and produce quality and innovative products. Additionally, we will keep assessing further opportunities to drive efficiencies and further optimize our value chain. In terms of financing new projects, Baladna has a good reputation among financial institutions and has a greater appetite for further strategic leverage for financing new project expansions locally or internationally.

To conclude, Baladna is fully dedicated to fulfilling its role as a market leader to contribute to the National Food Security Programs and Self-sufficiency Program in Qatar. We maintain our focus on creating shareholder value while at the same

time ensuring to serve our customers to the highest standard and ensure the safety and well-being of our employees and all the stakeholders. I thank you for your attention, and we'll now open the floor for any questions you have. Please, go ahead.

Operator: Thank you, sir. If you would like to ask a question, please signal by pressing star one on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, press star one to ask a question. We will now take our first question from Nikhil Phutane from CPFS, please go ahead.

Nikhil Phutane: Hi. Good afternoon, gentlemen. Thanks for the presentation in which you have quite detailed and mentioned about your products. My question relates to certain elements which have been identified in the presentation. First, on the daily yield per cow. In the first quarter, I believe the yield per cow was 39.3 liters, while in the second quarter it has dropped down to 38.4 liters. I wanted to understand what happened there. Second, in terms of your selling price, which you have mentioned is likely to increase, or as far as the government is concerned, do you have some timeline on this, and how will the selling price increase be in terms of raw materials? How will it be done so that your margins are protected?

Third, on your updates on the EVAP project, operations are expected to commence in 2023. Given the fact that already there are established players in the market, how do you see it going forward into 2023 in terms of revenue contribution and margins? Fourth, in terms of your long-term contracts, which you have mentioned, you are always planning to look into those. So how much currently, for example, for the first half 2022 do these contracts constitute as a percentage of total sales? And of course, one last question on the financial side.

I mean, why is there a need for investment in shares when you already have loans, which have increased basis, especially, Islamic financing? I mean, and of course, again, there is a loss as we can see it. So, just wanted to understand, what is the logic behind going for investment in shares that your main business has got to be something else? Thank you.

Saifullah Khan:

Thank you very much. First, you have mentioned that from Q1 to Q2, our daily milk yield has declined. This is due to the impact of seasonality as Q2 is marked with a hotter weather compared to Q1. As you can see, milk yield tends to be higher in colder seasons. If we look at global data, in particular the TSI index, it increased compared to last year, where the temperature and humidity have worsened. In these challenging conditions, we managed to maintain and even improve our yield. Seasonality is the reason why we are not comparing quarter on quarter performance and rather focus on year on year performance.

Regarding your second question about the selling price increase, we are following-up with the Ministry very closely, and we are having discussions with different government Ministries, because they are handling the market, and they understand our position compared to other players. Other producers and competitors in the market are also reaching out to Ministries for price increases. Ministries are considering the concerns of producers because local players have been affected by the worldwide commodity prices, and it has been noticed across the world that prices have already increased and consequently those who increased prices are able to show an improved profitability. And in our case, profitability is down because our selling prices are yet to increase to balance the increase in costs.

Our request is currently under process, and we are expecting a decision shortly, and it will only relate to an increase in selling prices . We are buying raw materials directly from the international market and the local market. There should be no impact from the raw materials side. The price increase has to compensate for the cost increase - feed is a major part, which we already highlighted in our financial presentation. You can see in terms of profitability impact; the main component is material costs which is reducing our margins. Otherwise, other factors had a positive impact on Baladna.

Regarding the third question about the Evaporated factory, which is ongoing, and we expect that by end of this year the construction and commissioning phase should be completed. We should have products on the market by next year. Regarding the point on the local competition, there are no local players currently in the Qatari market who produce evaporated milk, and the country is depending on imports.

The majority, 70% to 80% of demand, is from the government who is tendering from international markets, and they are bringing the products to the country, which they are selling. So there will be a chance that once evaporated products will be available, 70% to 80% will directly go to the government. So, we expect to be very competitively positioned to win some of these tenders, and we will provide it to the market. And the rest, 20% or 25%, will be through open competition in the market, where we will also aim to meet the market's requirements.

Regarding your question about the expected revenue and margins, we are expecting a healthy margin. Because there are synergies among the many functions of Baladna, there will be no increase in the capacity of these facilities

because we are only in need of production. Managing material costs will be a major consideration and we will also be using our excess milk in this facility. That's another advantage that Baladna has, which is the production of products from excess milk, which will be giving further benefits to Baladna in terms of margins. So, in terms of net profit, we are expecting a net profit margin between 10% and 15% and an EBITDA margin between 20% and 25%. From a revenue side, once this project will be fully completed, it is estimated that it will generate approximately QAR 200 million in terms of top line, but this is solely an estimate as of today and may change in the future.

Regarding your fourth question relating to investments in shares. Baladna has secured a shareholding exceeding 10% in Juhayna, Egypt, which is a very strategic investment for us. We are considering this as a strategic investment, we are not simply investing for trading purposes. The investment in those shares is aligned with Baladna's strategy in the long run.

Juhayna, is one of the market leaders in Egypt, which is a big market with a population exceeding 100 million. The population is growing, demand is growing, and the company is well established. As of today, the company's results and performance is very attractive, and we view this opportunity as strategic in the long-term. Additionally, behind this opportunity are detailed studies for its evaluation. I hope I have answered your question.

Nikhil Phutane:

Yes. Thank you for your detailed answers, which you have followed sequentially. Just one or two things which, as I believe, it has been missed out basically in terms of how much long-term contracts is there of your percentage of overall sales? And in terms of FIFA Cup, you have mentioned that you are maintaining inventories. So is it a request from the government? But, I mean, just wanted to

have an idea that, you know, FIFA is still a little bit further away, three to six months down the line. So this will unnecessarily absorb your working capital. So is there any plan that - I mean, you will continue with this strategy because of the government? Just wanted to understand that. And lastly, in terms of your evaporated project milk, 70% to 80%, you have mentioned from the government. So, this you're saying that you will come directly to Baladna, right? That's the understanding. And what will be the revenues from this, in case, suppose you already know the government has got 70% to 80%, what is the likely revenue, which you will be earning from this? Thank you.

Saifullah Khan:

Regarding your questions on the tenders, because of the worldwide increase in commodity prices, it is uncertain what will next year's tender value be, because prices have already increased by around 10% to 30%, especially for the powdered milk and wholesale milk powder categories. So, if you compare last year to next year, it will be completely different. I am unable to comment on the numbers, but I can give you the total value. What is the market's total size, and what is the proportion of that which we can target. The tender is capturing 70% of the market. So, we target that 70% of our revenue may be generated through tenders, which would be a highly secured revenue for Baladna, because as you know, Qatar's government is supporting local production, and they are using an in-country value scorecard, which gives the priority to local production. We are very hopeful that this will be considered, and the opportunity may come to Baladna.

Regarding your question about the FIFA 2022 World Cup. We have had very detailed discussions with the ministries, supreme committee, and retail players, five-star hotels, and catering companies which are already awarded the contracts. And they are aware of their volume, everyone has an expectation

regarding the potential market size of how much will be the increase during the FIFA World Cup period. We have very carefully evaluated that and we have made a promise to the people of Qatar that we will take care of the requirements during the event. We are constantly in follow up with the Ministries and we will reassure them that Baladna will take care of all the requirements.

That is why we started building our inventory because the increased demand will just be for a period of 40 days. Fresh products will be produced during that period only. But for the long-life categories, we have already started building our inventory, to avoid potential challenges relating to shortages. We are building our stocks taking into consideration what will be the potential requirements during the event. This should help us improve our top line and bottom line as well.

Regarding your next question about HORECA, 45% of the revenue growth is mainly coming from long-term contracts. So if I consider HORECA, it has a high contribution to the growth of total sales, which is predominantly relating to long-term contracts with big players in the market. The majority of agreements are long-term contracts which will secure our future revenue as well.

Nikhil Phutane: Okay. Thank you. Thank you, sir. Really appreciate all your effort in putting across the answers. Thank you.

Saifullah Khan: You are welcome.

Operator: There appear to be no further questions. I'd like to turn the conference back to the hosts for any additional or closing remarks.

Phibion Makuwerere: Hello. Yes. So with no further questions, I think this brings us to the end of our conference call. And we hope to have you again for the third quarter conference call. Thank you all for joining us.

Saifullah Khan: Thank you very much, everyone, for participating in our Q2 call. The Baladna team appreciates your time. We, as Baladna's management team, would like to express our gratitude and express our commitment to deliver shareholder value. Thank you very much.