Date: 12/04/2020

Ref.: MHC/Disclosure/2020/023

Boursa Kuwait Company

Mubarak Al Kabeer St.
AlSharq, Kuwait
P.O.Box 22235 Safat, 13083 Kuwait

<u>Subject: Minutes of the Analyst / Investor Conference Call for Results of Financial Year ended on 31/12/2019</u>

Reference to the subject line and in compliance with "Continued Obligation of the Premier Market Companies" as per Resolution No. (1) for the year 2018, Article (8-4-2). Mezzan Holding Company KSCP is pleased to announce that it held the Analyst / Investor Conference Call for the results of financial year ended on 31/12/2019, which was held through live webcast session on Thursday, 09th April 2020 at 02:30 pm Kuwait Time.

Attached hereto are the minutes of the Conference of the Investors earning call for results of financial year ended on 31/12/2019.

Mezzan Holding Company KSCP

Group Legal Manager

Walid Ali Khalil

Transcript of FY 2019 Mezzan Holding Company KSCP Earnings Call Webcast Transcript

Date: Thursday, 9 April 2020
Time: 14:30 Kuwait Local Time
Speakers from Mezzan Holding executive management:
Mr. Garrett Walsh - Group CEO
Mr. Fares Hammami - Group CFO
Moderator:
Fawaz Alsirri – Managing Partner
Bensirri Public Relations
Fawaz Alsirri:

Good afternoon ladies and gentlemen and welcome to this Mezzan Holding call to discuss the company's earnings for 2019 which was announced 24 hours ago.

Today is Thursday 9 April 2020 and this call is held live from Kuwait and Dubai

A recording will be available on the same link a few hours later.

My name is Fawaz Al Sirri. I am the moderator on the call today, and I am joined as well with today's speakers:

Mr. Garrett Walsh, the group's CEO
Mr. Fares Hammami, the group's CFO

A warm welcome to you all. I hope that you and your family and colleagues are safe and complying with directive of public health authorities.

I will soon handover the mic to Garry to kick off the call but before I do, allow me to take you through the format.

For the next 10-15 minutes, the speakers will make their statements after which we will have a Q&A session.

To participate in the Q&A segment, just type in your question on your screen at any time during the presentation. Starting from now and we will address it during the Q&A session.

I would like to mention that given current circumstances, we are currently practicing social distancing and as such working remotely from multiple locations which may take us longer to address questions.

I would also like to mention that some of the statements that might be made today may be forward looking. Such statements are based on the company's current expectations, predictions and estimates. There are no guarantees of future performance, achievements or results.

Mr Walsh , You may start.

Garrett Walsh:

Good afternoon everyone and thank you Fawaz and thank you all for joining us, and we welcome the opportunity to share with you our results for the 2019.

I would like to start this call by stating that these are quite difficult times for all of us and that we at Mezzan, and all of its employees from the front liners and support teams, are doing whatever we can to continue putting food and beverage, medicine and other healthcare supplies on the shelves, and have taken the reasonable and required measures to ensure the safety of our staff. Particular thanks goes to the catering teams in Kuwait as the serve those in quarantine.

I would also like to extend a sincere thank you message to each member of the Mezzan family who have for the past few weeks particularly, doubled their efforts to make sure the communities we serve in the region and elsewhere, are able to find our portfolio at all times. Both the board and I are true grateful.

Today I will take you through a short presentation discussing both the tailwinds we enjoyed and headwinds we faced during last year. I will then go through financial highlights, after which I will hand over to Fares, who will take you through the detail of the financial performance. Lastly, as Fawaz said we will be opening the floor for Questions.

From a tailwinds perspective, I am glad to say that 2019 saw the start of gradual improvement in our operational performance. This was driven by both the inorganic as well as organic initiatives we took in the last few years.

We witnessed topline growth in most business units. However, I would like to highlight strong performance in the food manufacturing and distribution, food services unit as well as the Non Food FMCG and Healthcare units. Each of these core units grew by healthy rates in the year.

We have also seen revenue growth in most key markets, albeit at varying rates. Fares will take you through this shortly,

Our UAE operations continue to support our performance and financial results throughout this year – which started earlier in 2019. We saw a pickup in energy drink sales and are witnessing ramp up of production lines which add both topline and profitability to our business in the UAE.

Revenue in Qatar and KSA has witnessed revenue have been also supported by the utilization of relatively new lines of production that went into force in 2018 where 2019 was first full year of operation.

2019 also saw the beginning of recovery in the profitability of catering segment after a few years of losses, despite the decline in revenue. We hope to see this continue further in 2020/

Furthermore, we completed a couple of key strategic growth initiatives this year; where we expanded operations in-organically.

Firstly, we acquired a majority stake in KSPICO – the only pharmaceuticals manufacturer in Kuwait and its consolidation was effective 6 August.

Secondly we also inked a distribution Joint Venture to distribute Medtronics and Covidien products in Kuwait starting in July. These have added to our scale and profitability and we expect the contribution to continue further going forward.

We are also growing our presence in KSA but expanding our fleet and warehousing capacities which are strategic goals of Mezzan, albeit painful from a profitability perspective , but these are long term investments

From a headwinds perspective, the cost of expansion of our in-house distribution capabilities in Saudi Arabia; whether one off expenses and one off listing fees continue to add pressure to our financial results. That being said, we still believe that the Saudi market is a key market for Mezzan and is a driver of future growth.

Throughout 2019, the bottled water market in Qatar remained challenged where the intensity of competition persisted. Our new lines of snacks are doing well and assist in subsiding the impact witnessed on the water business.

Finance cost increased as our borrowing increased to fund the growth in balance sheet size driven by the acquisition of KSPICO and the other new businesses. This will be addressed aggressively in 2020.

Finally, we also recorded non-cash and one-off impairments losses as result of impairment of goodwill as well as reduction in value of an intangible asset resulting from implementation of IFRS 16 and the ensuing reclassification of accounting treatment of one property which weighed on net profits. Whilst these are non-cash in nature, we believe it appropriate to continue with our conservative approach to our asset valuation.

I would like to mention the board of directors has recommended a cash dividend of 15 fils per share for 2019.

This is subject to the approval of the General Assembly.

As for financial performance, Mezzan recorded improved operational results in 2019 as evidenced by enhancement in key operational metrics including Revenue, Gross Profit, and Earnings Before Interest, Taxes, Depreciation and Amortization.

However, we recorded a drop in net income driven by non-cash one-off losses; impairment of intangible assets of KWD2.4 million: which included a KWD1.2million goodwill impairment for one our subsidiary in KSA as well as a KWD1.2million impairment of another intangible assets as a result of an accounting standards reclassification of a real estate property through implementation of IFRS 16, as well as IAS38.

If we were to exclude these non-cash losses, our net income to the shareholders of the parent company would have been in fact up compared to last year.
In terms of our financial highlights and headline numbers
for the 12 month ended 31 December 2019;

- Mezzan's revenue reached KWD222.5 million up from KWD207.5 million in the previous comparable period, for a growth of 7.2%.

- Gross Profit reached KWD 48.7million compared to KWD44.0 million in the comparable period, for an increase of 10.7%.
- While EBITDA reached KWD 18.5million, up from KWD 15.6 million in previous year, for an increase of 18.5%.This is important in light of the increased production capacities and efficiency enhancing initiatives we completed recently.

- Finally, Mezzan's net profit to shareholders of the parent company reached KWD5.6 million during 2019, compared to KWD7 million during the comparable period of the previous year.

- The drop in net profitability is driven by the non-cash one off impairments mentioned previously.

And at this point I will hand over to Fares to take you through the financials in more detail.
Fares Hammami

Thank you Fawaz and Garry. As Fawaz stated earlier, we are doing this call from multiple areas and as such might face some delays. I apologize for that.

I would like to remind investors that effective 1st of January 2019 new IFRS standards 16 for operating leases became effective. The operating leases have been capitalized onto the balance sheet with an asset and liability value being time value discounted for rent expenses. As such, the rent expense of operating leases have been reclassified into depreciation and interest expenses by the same amount and as such net income was not materially impacted.

The reported numbers of 2019 reflect these accounting changes.

In the twelve month period ending 31 December 2019, operating leases were capitalized onto the balance sheet to the tune of KWD 3.2 million, and rent expense was reduced to the tune by KWD 1.36 million as it was reclassified to additional depreciation of KWD 1.23 million and additional interest of KWD 0.13 million.

In addition to the above, the adoption of IFRS 16 in 2019 & ensuing implementation of IAS38 as such triggered a reclassification of one property into an intangible assets which in turn triggered an impairment of KWD1.2 million as a result of a drop in the value of that particular asset. It is key to note that such losses were non-cash.

As for revenue contribution by business line for Mezzan Group.

- The food group accounted for 72.1% of total group revenue in 2019, for a growth of 3.4% compared to 2018;

- while the revenue of non-food group accounted for the balance of 27.9% of total group revenue, for a growth of 18.9%.

- Within food group, food manufacturing and distribution contributed to 48.4% of the revenue in 2019, registering a strong 5.8% growth compared to previous comparable period which was driven by strong performance in Kuwait, UAE and KSA from a topline perspective

- Our catering business contributed to 16% of revenue in 2019 for a decline of 6.1% although this did not impair profitability. To the contrary, the catering businesses witnessed growth in profitability during that period.

- Lastly, Revenue from our Services segment within the Food Group increased by 10.8% in this year and contributed to 7.8% to 2019 revenues.

    - In our non-food group FMCG and Healthcare had a very solid performance in the period ended 31 December 2019, and the revenue of the segment now accounts for 25.6% of Mezzan's 2019 revenue, for a growth of 21.9% compared to comparable period in 2018. The growth was particularly from the acquisition of KSPICo and new brands like Medtronic and Covidien which started in Q3 last year

    - While revenue of industrials group slightly declined by 6.9% and contributed to 2.3% last year.

- Geographically, Kuwait contributed to 69.4% of Mezzan's total top line and was up 6.9% resulting from a strong performance from food manufacturing and distribution and non-food FMCG and Healthcare businesses alike.

- Revenue from our operations in the United Arab Emirates as Garry mentioned earlier increased by 8.4% compared to 2018. The revenue increase in UAE is driven by measures we took over the last year on both trading and manufactured items alike.

- Revenue in Qatar grew by 5.1% in 2019 compared to 2018 now contributes to 10.3% of Mezzan's revenue.

- Saudi Arabia accounted for 2% of Mezzan's revenue in 2019 for a growth of 13.5% compared to 2018. The increase resulted from securing new stock into Saudi Arabia through the added chips and snacks capacities now on line in UAE.

- In Jordan, sales were down by 3.3% and that market contributed to 2.5% of Mezzan's revenue.

- Revenue from operations in Afghanistan was up 23.1% during this year. This market accounts for 3% of Mezzan while operations in Iraq accounts to only 0.9% of Mezzan's total top line.

Moving to the Profit and Loss, in 2019, Mezzan Group recorded

- Revenue reached KWD 222.5 million, for an increase of 7.2% compared to 2018. As explained before, this was driven by topline growth in almost all key markets.

- Gross profit reached KWD 48.7 million in 2019 compared to KWD 44.0 million in the previous comparable period, and Gross Profit Margin reached 21.9%, an enhancement of approximately 110 bps.

- Selling, general, and administrative expenses (SG&A) expenses increased by 8.4 % in the twelve month period ending 31 December 2019 mostly on the back of new business. Driven by flattening of G&A expenses and increase of S&D given new acquisitions.

- EBITDA reached KWD18.5million, up from KWD15.6 million in previous year, for an increase of 18.5%.

- This is important in light of the increased production capacities and efficiency enhancing initiatives we completed recently as well inorganic growth and capex we have completed over the past 3 years.

- Financing costs and other expenses increased to KWD 6 million in 2019 compared to KWD 3.4 million in 2018. Financing cost increased by around KWD 1 million compared to last year funding the acquisitions and growth in working capital.

- The increase is attributable to higher borrowings due to funding the acquisitions of KSPCIO and other new businesses in Q3

In summary, Net profit had reached KWD 6.3 million in the twelve-month period ending 31 December down by 5.0% from comparable period in 2018. This includes the one non-cash losses of KWD 2.4million discussed earlier.

Drop in net income driven by non-cash one-off losses; impairment of intangible assets of KWD2.4 million: which included:

- KWD1.2million goodwill impairment for one our subsidiaries in KSA; as well as
- KWD1.2million impairment of another intangible assets as a result of an accounting standards reclassification of a real estate property as a result of implementation of IFRS 16 which started in 2019, and IAS 38.

If we were to exclude these non-cash losses, our net income would have been in fact up compared to last year.

Net profit attributable to equity holders of the parent company reached KWD 5.6 million in 2019 compared to KWD 7.0 million in the comparable period of 2018 for a decrease of 19.0%.

Again, 2019 Net profit to shareholders of parent company includes the non-cash one-off losses of KWD2.4 million mentioned earlier. If we were to exclude these non-cash losses, our net income to the shareholders of the parent company would have been in fact up compared to last year.

From a cash flow perspective, Mezzan recorded

- operating cash flow before working capital changes of KWD22.3 million in 2019, up by KWD 5.3 million from comparable period from previous year.
- In the year 2019, we invested in KWD 11.4 million in working capital compared to investment of KWD 6.5 million in 2018. Investment in working capital was primarily driven by the acquisition of new businesses, both KSPICO and new agencies. This iis also building for the future.
- Cash flows from Operating Activities reached KWD 10.9 million in the period 2019, compared to KWD 10.5 million in 2018.
- Cash flows used in investing reached KWD28.8mn given the acquisition of KSIPCO, the additional stake in the subsidiary in KSA as well as maintenance capital expenditure
- Cash Flows used before Financing Investing Activities amounted to KWD17.9 million in 2019 compared to a positive KWD 3.5 million in 2018 driven by the expansion as described earlier.
- Our Net Debt increased by KWD28.9 million in 2019, compared to an increase of KWD 10.8 million in the comparable period 2018, again funding future growth.

From a balance sheet perspective, it is key to remember here that 2019 witnessed the completion of several inorganic initiatives including the acquisition of 66.994% stake (majority stake) in KSPICO as well as our entrance into Joint Venture business to obtain the rights of Medtronics and Covidien, which were financed through borrowings.

That led to increasing the balance sheet size of Mezzan, assets to reach KWD260.3 million as of 31 December 2019, and given the bank debt funding, increased our Net Debt to reach KWD74.4 million and Net Debt to Capitalization Ratio to 41.4%, while Equity to shareholders of parent company reached KD 105.6 million.
I will now move the discussion to Garry who will discuss the forecast for 2020. Garry, floor is yours.

Thank you Fares. Obviously, based on the acquisition we made and the performance of the underlying business we expect to see our topline to grow by double digit this year and on the back of the fixed cost base, we would expect to see high double digit growth in EBITDA and high double digit growth in the Net Profit.

We are not anticipating any accounting treatment adjustments. Capex will be reduced as we push ourselves towards addressing debt quickly.

We have seen nothing in the first quarter which would disabuse of the items on the screen.

Fawaz Alsirri:
Thank you Garry. Thank you Fares. We will now be taking any of the audience's questions. Several of you have already sent them through, so we'll take them one by one. Give us a minute.

We're going to start off where Garry ended. We have a question; part of that question was already just answered relates to guidance for 2020. The other part of his question is, and I'm going to read it to you now, it says, what is the impact of COVID-19 on each segment so far from what you have seen? Garry?

Garry Walsh:
So, good question. Effectively from our perspective, obviously we operate in a number of different jurisdictions, and the reality is that each jurisdiction has responded at a different time and in a different way to this emerging threat.

We have areas of our business such as the services where it has had little to no impact, and those already operate under a high level of security and a high level of lockdown.

And within our core businesses, I think it would be fair to say that we've seen a move away from the more luxury items, to more discretion, to more commodity-based items.

So, if I look at our FMCG business for example, we would see things like an antiseptic liquid, sanitizers, etc., toilet rolls, accelerating in sales very rapidly but we would also see things like luxury shampoos, makeup, etc., reducing. So, overall we believe that it will have a relatively neutral effect on the business in Q1 and Q2, relatively neutral to positive.

However, our focus is on Q3 and Q4 at the minute, and making sure that our supply chain remains robust, given all of the issues that we currently face.

Fawaz Alsirri:
Thank you. Next question is, why was net income negative by KWD 2.1 million in manufacturing, distribution and food segments in the fourth quarter? And how much would it have been without higher expenses from KSA? Fares, you want to take that one?

Fares Hammami:
Sure Fawaz. While the fourth quarter comparatively on the food and manufacturing distribution segments has dropped by around KWD 2.1 million. But that has a couple of points we need to recall.

First of all, last year we mentioned that we had sold in the previous year, so in 2018, we had sold a land that was clubbed within the food manufacturing distribution, that was a gain of KWD1 million. So, there was a one off KWD 1 million gain on the previous period, which now accounts for this part of the delta.

The other part of the delta is, as we said, it's not only Saudi, obviously we've mentioned that there's been some difficulty in operating the water line in Qatar, and we've also taken one-off impairment losses or trading losses in one of our subsidiaries in Kuwait. And the last, this was an accounting standard impact relating to end of service benefit, one-off impact by around KWD200k.

So, we're talking about multiple reasons. It's not only just operations in Saudi. On the Saudi bit as you know, unfortunately we don't mention performance per country, per profitability and unfortunately I'm not at liberty to share that.

Fawaz Alsirri:

Thank you Fares. We have a follow-up question, will you be able to reach 2017 net income levels in 2020? Fares?

Fares Hammami:

We obviously, never crystal ball a certain figure.. So, if you're comparing it to a specific number in 2017 we can not just say that.

However, I would use the guidance that Garry had mentioned.

Obviously we don't anticipate the one-off impairments that we took this year to happen again and obviously we do anticipate some growth given the annualization of the acquisitions that we've completed and the FMCG segment.

And obviously the continuation of the development of the profitability in some of the segments that we've recently invested in, including the reversal of losses that we've started to witness in 2019 in the catering business.

So, unfortunately I can't tell you whether we'll reach a certain figure, but we do anticipate high double digit growth especially compared to 2019.

Fawaz Alsirri:

Thanks. Next up a question. Parts have already been answered, but the other part is also connected to the COVID-19 crisis. Khalid is asking, what are the effects of COVID-19 to the company? Can you explain both the positive and the negative side please. And Garry?

Garry Walsh:

I can honestly tell you that the answer to that question changes every single day.

If you look at our business in Qatar for example, in the middle of March, our facility was put under quarantine as part of an initiative to quarantine the entire industrial area within Qatar. You know, there's a human cost to that. Obviously we had 300 people trapped on the site. It was very difficult to get trucks out to actually service the market with essential supplies i.e. water and other things. So, you could put that down as a negative. We had within our catering business in Qatar, we had 350 people quarantined merely because they lived next door to a building where there was COVID cases. Fortunately over the last two weeks those scenarios have unwound and we thank God for that.

However, just two days ago, Kuwait closed two areas of the country on lockdown where we have a number of our staff and so, the answer honestly changes on a day by day basis.

What I can tell you is that so far for every negative, we've found a positive.

So, if you look at our catering business, the guys have done a great job starting to supply quarantine meals to people under official quarantine in Kuwait.

I would certainly congratulate the Kuwait authorities in the way they've approached the whole matter where they've made sure that the resources were lined up to deal with their decision, as they made those decisions. And that's been a benefit to our catering business, slightly towards the end of March and more so in April obviously, as the numbers under quarantine increase dramatically.

On our core food business, we've seen things like rice, tuna really sell rapidly. I have some skepticism as to whether those are long term gains or whether they will reverse in the second half of the year. But as I said, when we were given the guidance on balance, we believe that our guidance for the year is robust even in the COVID scenario. I hope that gives you the answer you need.

Fawaz Alsirri:

We have one, two, three questions in one. So, I'm going to read them, all three questions and then I'm going to hand over to Fares to tackle them one by one.

Her first question is, you incurred an impairment expense of 1.15 million for the recent KSPICO acquisition. If you are impairing an acquired asset soon after acquisition, doesn't this mean you overpaid for the asset? What are the problems you are facing with this asset and what is the outlook for 2020 for this asset, in terms of profit generation and in terms of further impairment.

The second question is, how long do you anticipate marketing and promotional activities/listing fees within KSA to go on for?

And her third question is, can you give us more details on the KWD 20 million increase in receivables in 2019 and what are you doing to address the issue? Over to you Fares and I hope you got it all down.

Fares Hammami:

Doing the call remotely makes it more difficult. But let me try to see, I think I if I heard you well, you said that the first question regarding KSPICO, that we took a hit of impairment expense.

That's not true, the two impairment losses that we incurred this in 2019 where one, an accounting reclassification-triggered drop in valuation of a property in Kuwait. So, we had it previously recorded as a property and given the implementation of IFRS16 in 2019, we had to reclassify that asset into an intangible asset. And as you guys are aware, intangible assets are not amortized but rather have an impairment testing every year. When we did the impairment test this year for the first time, there was a drop in the valuation and as such, that asset took a hit. And the other part was a KD 1.2 million impairment of goodwill. Again, we do goodwill testing every year as part of our closing process and there was one investment in Saudi Arabia that we had the goodwill for and we had to take an impairment of KD 1.2 million. Just to erase any confusion, neither of these one-of impairments relate to KSPICO at all.

If I recall, the second question Fawaz, I think you said, how much do we expect the marketing and promotional activities and the one-off losses in Saudi to persist?

Well, obviously we are still building our distribution channel in Saudi Arabia. If you recall, we bought just a few years back. However, for obvious reasons, we couldn't supply as much. We started supplying products more meaningfully in 2019 which meant that we started investing in the distribution, sale and distribution and the promotional activities in 2019.

One can't cover a market as big as Saudi Arabia in one year, so this is a timely proposition. However, we do anticipate if the plans that we're doing do progress and proceed, we do anticipate that the losses in Saudi to subside substantially this year.

And the last bit I gathered was an increase in receivables, well an increase in receivables and increase in inventory that's happened in Mezzan is obviously driven by the acquisition of businesses.

We acquired KSPICO in 2019 and obviously KSPICO has exposure to certain ministries and sells to certain ministries and as we've always mentioned, that ministries do have a longer collection cycle. That doesn't mean that we have a credit risk but rather maybe a timing issue which is always priced in our pricing. And obviously we also became the agents for Medtronic and Covidien in Kuwait and have expanded the business going forward in 2019 for the future by investing in working capital.

What are we doing to release the trade receivables?

Obviously we are really now focusing more on putting aggressive plans to collect faster from our customers generally including some governmental accounts as well as other customers. Back to you Fawaz.

Fawaz Alsirri:
Thank you. The next question is going to be for Garry. The question is can we get more colour on the new pharma acquisition - how does this fit into the overall portfolio, how has been the topline / bottomline for this asset over the last 12 months, how should we think about growing this business going forward?

Garry Walsh:

Good questions. I'll try to answer them as best I can. Feel free to come back on with follow-ons if I miss anything. Obviously from our perspective we had a medicine business within Kuwait but it was number six in the market. We are very clear that our ambition for most of our businesses is to be either number one or number two in the market or to exit. When this asset came on sale, or for sale or when the majority stake and it came up for sale, we looked at it and liked it for several reasons.

One, we have a factory that is very well invested but underutilized but still profitable, which is important.

We have a plot of land which is open for development and obviously in Kuwait land is at a significant premium given the restricted geography of the country.

And thirdly, we felt that the new management team we had brought for the medicine division anyway, would be able to better maximize that business.

We have several routes forward for us. Obviously we are currently in the process of installing some new lines within the business and we'll update people on those as they come on soon.

Secondly, we're filling out what I would call distribution gaps in our FMCG or our food business.

I'm not sure what you call them in the medicine business, but effectively products that we are capable of supplying to the market which we have not been tendering for or supplying to the market.

So, I think realistically we would like to see that business grow aggressively over the next three to five years. We expect to see a very positive impact on the business this year, even net of the substantial interest payment and we'll discuss that in more detail as we go through each quarter.

Fawaz Alsirri:

Thanks. Fares, the next question is for you , can you please give us guidance on the working capital needs in 2020 and what cash conversion cycle can we expect going forward?

Fares Hammami:

Obviously with COVID, the answer becomes very, I won't say tricky but rather, no one can crystal ball what's happening.

However, we do anticipate that we will be able to reverse part of the receivables and collect cash faster. Especially for certain accounts as I've mentioned earlier.

And on the inventory and payables side, we're looking at these situations very closely.

We manage our relationships with suppliers and at the same time we have some, we've obviously given covered, as Garry mentioned earlier, some parts of our portfolio were sold quite well, but we also need to build for the future.

So, all I can say on the working capital conversion cycle is we do anticipate improvement. Can I quantify? We have our plans with certain numbers but I can't release that.

Fawaz Alsirri:

Right. Next question is, do you expect to benefit from ventilator sales to hospitals from COVID19-related respiratory issues and how big are respiratory sales for Medtronics and Covidien?
Garry Walsh:

Okay. So I can't answer for Medtronics themselves.

Unfortunately the Medtronics business in Kuwait is split across three distributors from memory and ventilators does not fit within our category. So, unfortunately from a business perspective, I don't expect to see any benefit to the Medtronics business from the current scenario.

As I said earlier, we are seeing real growth in our medical supply business, in our sanitizer business, but in those specific businesses if anything, I would see them being slightly inhibited in the first quarter as people put off any discretionary operation.
Fawaz Alsirri:

Thanks Garry for that. The next question we're going to take is for Faresgiven the high leverage in the business, where do you see the business comfortable in-terms of net debt/EBITDA term? Fares?
Fares Hammami:

We're at where we think we're comfortable at. So, just to put things in perspective, our net debt currently now is at KWD74.4 million. Obviously from an EBITDA perspective, this is about 3.5x closer to 4.0x which is where with our comfortable or maximum of the comfortable zone that we're in.

However, the comparison is not necessarily fair. You have to take an annualized EBITDA for the businesses we acquired in the second half and the organic growth that's happened in the second half as well. So, that being said, we do anticipate that naturally drops throughout the year, but also hopefully should we be able to reverse some of the working capital investments, we'll be able to reduce some of the borrowing as well.

Fawaz Alsirri:

Right. The next question is going to be picked up by Garry. Are there any restrictions on price increases for your food manufacturing distribution division products by the government?
Garry Walsh:

Again, the main restriction on our pricing would be within the co-ops in Kuwait where that has to be approved by the union of co-ops before it can be applied to the market.

If I understand the nature of your concern, it's probably around any inflationary impact on the business given the current disruptions to the supply chain. So, in that context, the Kuwait government have been very proactive in terms of providing support for any increased costs.

So, for example, if it was costing me a dollar to ship something from India last week and that goes up to $2, they will pay the difference. There is a formal scheme in place.

We've already started applying for that scheme in various parts of the business and that's really how they've chosen to ensure that their citizens and residents don't suffer through this tragedy.

Fawaz Alsirri:

Thank you. And just to manage everyone's time, we have eight more questions to go and they range on different topics from COVID reactions to general business and capacity and some financial questions as well. So, if you're thinking about asking a question, please send it over. We're still taking in questions.

In the current COVID19 lockdown situation, are you still seeing demand from the catering segment? How will you be able to maintain profitability and can we expect better operational efficiencies going forward and thereby better margin?
Garry Walsh:

Okay. On the catering segment, we are still seeing demand in the market where we have government contracts. Obviously those are continuing as normal in many cases, some of them are slightly reduced but broadly okay.

Things like construction contracts or labor contracts, obviously those laborers are still there, they still need to be fed. So, those contracts are continuing as normal.

Where we are seeing a marked reduction would be on private catering, where we would typically have serviced weddings, etc. That's a relatively small part of our business though and that is being compensated by the quarantine meals that I referred to earlier.

So, from that perspective we expect to be able to maintain profitability.

I'm a little bit worried about March in Qatar due to the people that we had in quarantine. But overall we think it’s a phase and we'll be okay.

And can we expect operational efficiencies going forward? Yes. I believe we had started to demonstrate those last year. We've expanded growth margins, expanding EBITDA and we do expect to see that continue throughout this year.

Fawaz Alsirri:

Thanks. Next question is should we expect higher profitability due to lower interest rates?
Garry Walsh:

Hi Khalid. That was part of why we had our board meeting yesterday, that was a topic of hot discussion.

Obviously that's been introduced to help offset some of the negative impacts of COVID and again the Kuwait government have been very proactive in dealing with the interest rate.

Most of our borrowings is in KD or dollar. So, we will see those costs go down. But as I said previously, we will see positives and negatives out of COVID and overall we expect a balanced result based on our previous guidance.

Fawaz Alsirri:

We're going to ask, the next question we're going to ask is for Fares. Is the guidance of the high double digit growth or net profit in 2020 adjusted for the 2.4 million non-recurring write down down of intangibles? Or does it include them?

Fares Hammami:

Guidance is we should be achieving high double digit growth whether you compare it with the KWD 2.4 million one off non cash impairments, or without. I think that answers question.

Fawaz Alsirri:

Thanks. Also, another question is, how much do you expect to save on finance costs going forward given lower rates? How much for each 25 basis points decline in interest rates?

Fares Hammami:

I mean obviously there's two factors for the interest expense.
One is the volume of borrowing and one is the rate.

So, the rates are down and obviously we should be saving on that front. That being said, however, our borrowing has increased last year. They've increased last year, but mostly towards the second half of last year. So, there would be an impact of growing interest expense throughout the year given the higher borrowing until we are able to start paying down some of the borrowings.

So, obviously we should be able to see some interest expense drop.

if you look at our borrowings, its around KD 75 million on net basis , you're talking about roughly KD 180,000 worth for every 25 basis point drop in rates.

That being said you can't say we've dropped four times from that. So, we'll save a million simply because we would have the larger borrowings for longer period in 2020 than we had in 2019 given the timing of this borrowing.

Fawaz Alsirri:

Thanks. Next question is: how is the UAE business doing amidst recent development in terms of volume and pricing and how should we expect UAE operations to perform in 2020, given the risk relating to tourism business? Garry?
Garry Walsh:

In terms of the impact of the various shutdowns in March, we have seen a substantial increase in our retail-led business and a substantial decrease in the on-premise business.

It's important to note that the on-premise business forms a much smaller part of our business than the retail business. So, I don't have the numbers in front of me, but we do see good growth in the UAE over the first quarter and in March.

We are looking at our cost base and how we address the food services sector.

Obviously, not only do we have a distribution outlet but we have a meat factory which is a large supplier to the fast food industry in particular. So, we're just working through the implications of that.

But as I keep saying, there will be positives and negatives in this, but overall we expect to be in line with our guidance.

Fawaz Alsirri:

And back to Kuwait, we have the following question, what percentage of food businesses in Kuwait is through cooperatives and do you expect any payments issues given the current situation?

Garry Walsh:

In terms of the co-op business, roughly, 55-60% of our retail businesses is through the co-ops. T

hat business is factored through KFH. We've been operating under the new processes they've put in place for the last three years and we've not seen nor do we expect to see, any delay in payment from the co-ops.

If the second part of your question refers to other customers, we took a decision when COVID hit, to prioritize the service of the cooperative and bigger retail chains over the smaller businesses that we would customarily deal with.

So, therefore we believe that relatively speaking we have a small exposure and we are pushing very hard to collect that money throughout this month, but I don't see any risk emerging.
Fawaz Alsirri:

Next question reads, why did receivables increase by KD20 million year on year and are there any plans to reduce them going forward? Net debt/EBITDA is 4.0x. Do you have any issues with covenants? What are your plans to reduce debt levels?
Fares Hammami:

I think we've already answered quite a bit of this.

Receivables went up primarily on the back of acquisitions and whether acquisitions through companies or at the same time growth in working capital or investing in brands, which means you invest in working capital.

The second part is, obviously we have plans to reduce them, as I mentioned earlier. That we'll try to unwind some of the receivable tie-ups, especially with some governmental accounts.

The last bit of the question I think relates to plans to reduce debt, I mentioned that.

The question part or the part relating to our covenants, no, we don't have an issue.

As I mentioned earlier, if you look at net debt to EBITDA at a certain point in time, it's different than what actually the operations are.

We've borrowed the additional money towards the end of the year and we had no profit to show for the first eight months or nine months for that borrowing.

So, obviously our EBITDA would have been higher had we acquired earlier in the year. We cannot be victimized on that. It's just the timing of when the deal closed.

This applies to pretty much the growth initiatives that we've taken inorganically in 2019 being the KSPICO, Medtronic, Covidien and agencies wide. So, obviously, if we were to take an *annualized* EBITDA on the current rates of performance of these subsidiaries or these new businesses, this net debt to EBITDA covenants would have definitely different.
Fawaz Alsirri:

Fares. We have a follow-up question on a previous question in regards to the goodwill impairment loss, which particular Saudi asset was impaired and can we expect more of this going forward?
Fares Hammami:

Mezzan as a holding company fully owns a company that in turns own majority of Mezzan Foods (Saudi Arabia), which is the operating subsidiary.

So, the impairment testing happens at the owner of the shares of Mezzan Foods entity, which is the holding of the fully owned subsidiary of Mezzan.

That entity is you see in our financial statement is called Mezzan Saudi Arabia.

So, it relates to the actual impairment is triggered by the results of the Mezzan Food Saudi, but obviously Mezzan Foods as the entity, that is investee, isn't impaired itself. That happens at through the shares of the company that's owned, which is Mezzan Saudi.

At the end of the day, we control both and own both and it's all consolidated under Mezzan. So, that's why it obviously comes up to the Mezzan level.

Fawaz Alsirri:

Thanks. Next up is a question Its going to be picked up by Garry. Can you describe the process of your business in Afghanistan purchases in advance and how frequent is the renewals of your customer contracts? When is the next renewal?

Garry Walsh:
I will try to answer that succinctly. Feel free to ask a follow-up if I'm not clear.

So, within Afghanistan we broadly have two businesses. We have a bakery business and we have a fresh fruit and vegetable business.

Within the bakery business, we currently have a supply chain of about two months. We've just expanded that over the last week to four months, given the current circumstances.

On our fresh fruits and vegetables business, which is the second business, we engage in contract farming where we would typically have commitments out for about a year. Currently those are in place and we have no intention to expand them.

I don't believe COVID will warrant holding extra stock in that area or committing to extra stock in that area.

In terms of our customer, our customer is, typically the way it operates is you get a five year contract, there are then a number of one year extensions depending on the particular circumstances.

On Monday last, our customer was awarded the next five year contract. So, obviously there is no commitment in terms of numbers or anything like that. But physically they have the contract now for the next five years and obviously that will come up for tender in another four years. I hope that answers the question.

Fawaz Alsirri:
The next question is - can we get more color about your water business in Qatar?
Garry Walsh:

The business in Qatar is tough. When the embargo went down, obviously all water exports from Qatar were stopped. At the time between 40 and 50% of all water produced in Qatar was exported.

The government decided to introduce more water licenses to ensure supply. So, the market has wound up being, having extreme over capacity.

I think it's fair to say. Despite that, we maintain our number two brand position in the market. The team are working extremely hard. We've invested to reduce our cost base through installing a pre-form line there and as we've mentioned or as Fares mentioned previously, we've also built a snack factory on that site and to spread the load a bit more. The site made substantial progress last year and we expect it to make substantial progress again this year but it is a fight every single day.
Fawaz Alsirri:

Thank you Garry and I think ...I'll just taking a quick look at the questions. Yep. We have answered every single question we've got and we're not getting any more questions. I think with that we'll conclude today's call.

Thank you Fares and thank you Garry for taking the time to answer all these questions and going in detail in your answers.

We will be concluding the call right now

As I said earlier, a live recording of the session will be available on the same link you used to access the live one in about two hours or so.

Thank you everyone for joining. We'll see you in the Q1 call and for now, have a good day and stay safe.

****