Conference Call transcript

10 August 2017

PALM HILLS Q2 2017 RESULTS

Operator
Good day ladies and gentlemen and welcome to the Palm Hills Q2 2017 financial results conference hosted by Renaissance Capital. All participants are currently in listen-only mode and there will be an opportunity to ask questions later during the conference. If you should need assistance during the call please signal an operator by pressing star and then zero. Please also note that this call is being recorded. I would now like to turn the conference over to Balram Ramesh of Renaissance Capital. Please go ahead.

Balram Ramesh
Thank you Chris. Good day everyone. This is Balram Ramesh from Renaissance Capital and I would like to welcome you to Palm Hills Development Q2 2017 earnings conference call. We are happy to have with us on the call today Mr Yasseen Mansour, Chairman, Mr Tarek Abdel Rahman, Co-CEO, Mr Ali Thabet, CFO, and Mr Mamdouh Abdelwahab, IR and Investments Director. We will begin with the management discussion followed by a Q&A session. With that I would like to hand over the call to Mr Mansour. Sir, please go ahead.

Yasseen Mansour
Thank you Balram. Good afternoon ladies and gentlemen and thank you for joining our second quarter of 2017 earnings conference call. In today's call I will briefly present to you the key highlights, then I will hand over the call to Tarek Abdel Rahman to walk you through the financial results and afterwards we will open the floor for questions. The second quarter of 2017 marks another strong period for the company in terms of new sales, profitability and handovers backed by the ongoing healthy demand for our product offering across all operating regions. Despite the second quarter being usually the slowest in the year we witnessed a remarkable 156% year over year growth in new sales to record EGP 2.5 billion supported by new launched in west of Cairo, north coast, demand for available for sale inventory and projects nearing completion, coupled with strong uptake in recently launched commercial developments in west Cairo. New sales for the first half of 2017 marked EGP 5.6 billion with a growth of 85% year on year. While the market is still strong we believe we are still gaining market share with 1,227 units sold during the first half of 2017. We handed over 885 homes during the first half. We spent EGP 1.3 billion on construction and generated EGP 2.3 billion in cash from operations, which translates to a growth of 77% year on year.

Looking at our recurring income and commercial real estate portfolio we started to unlock value from non-core assets with the launch of Palm Valley Mall and Palm Central office building in west Cairo during the second quarter of 2017 with new sales recording EGP 493 million with almost complete sell-out of available for sale office space in Palm Central. During the first half of 2017 our recurring income portfolio contributed 15% to net profit driven by partial recovery in tourism with room occupancies remarkably improving the company's three operating hotels coupled with profitable growth in Palm Club's operations. Our financial results for the first half of 2017 reflected our operational excellence with revenue of EGP 3.2 billion and EBITDA of EGP 629 million, a growth of 49% and 89% respectively. Net profit after minority interests grew 106% year on year to reach EGP 349 million compared to last year EGP 169 million. Our balance sheet maintained a strong position with receivables of EGP 13.3 billion covering net debt more than four times.

We successfully concluded negotiations with some of the leading banks and were able to reduce the applicable interest rate to 0.75% [?] of the company outstanding debt. The reduction in interest rate will result in total savings of EGP 100 million on financing cost to the company. We remain committed to deleverage the balance sheet through our EGP 2.5 billion securitisation of receivables programme over two to three years as we have previously announced. We are still preparing for two securitisation transactions which are expected to address receivables of over EGP 1 billion closing before year end. We have received this portfolio earlier this week and expect to receive the bank approval on this counting of another EGP 300 million of our receivable portfolio.

We have also received the board approval of the New Urban Communities Authority, NUCA, for the 3,000 [unclear] at the end of June 2017. Through this mega development PHD expect to create 500,000 jobs and house up to 200,000 Egyptian citizens. We are currently finalising the project master plan and expect to launch new sales during the first quarter of 2018. Given the strong market conditions and ongoing housing supply demand mismatch the company remains on track with previously announced full year 2017 targets with new sales of EGP 9.5 billion. With that I will hand over the call to Tarek to walk you through the results. Thank you.

Tarek Abdel Rahman
Good afternoon ladies and gentlemen and thank you very much for joining us today. We continue to see the market as growing extremely strongly both in Cairo west and east and in the north coast, like Mr Yasseen said. Net sales for the first half were EGP 5.6 billion, a growth of 85% year on year. We started unlocking significant value from our commercial real estate portfolio by selling office space in Palm Central and by selling retail space in Palm Valley Mall. The sales for the first half were EGP 500 million at both locations in west Cairo with residential new sales being EGP 5.1 billion. Not only are we seeing an improvement in terms of pricing of real estate with the land [?] continuing to be strong, hence driving up prices, but also in terms of volume volumes are extremely strong and growing. We were able to grow volume sales by 55% half over half. We sold the first half 1,237 units as opposed to nearly 800 units in the first half of 2016.

Also since the beginning of the year we increased our average prices for built-up areas by 68% for standalone units and by 47% for apartments, whereas we increased the price of land by 37%. We saw an increase in the construction cost as well especially beginning of July because the government had removed the subsidy on fuel and this obviously affects the cost of everything and inflation in general. However given the supply demand dynamics in the market we remain confident that we are able to pass any increases to the end buyer, as evidenced by an average of between 40% and 70% price increase during the first half of the year. Construction is also progressing extremely well and on budget. We were able to record EGP 1.3 billion in construction in the first half, a growth of 11% year over year. And that translated into handing over 885 units, a 7% growth year over year. We remain well on target to deliver our 1,600 units for 2017.

We see the numbers in our Palm Hills Club continue to increase to 2,500 between Palm Hills Club and our three hotel assets that we own a majority in. Recurring income portfolio made up 15% of net profits and we remain on target to achieving 25% by 2020. I think Mr Yasseen Mansour has discussed the results in detail. And with that we may open the floor to any questions you may have.

Operator
Thank you very much sir. Ladies and gentlemen, at this time if you do wish to ask a question please press star and then one on your touchtone phone. If you decide to withdraw your question please press star and then two to remove yourself from the queue. Again if you wish to ask a question please press star and then one now. We will pause a moment to see if we have any questions in the queue. Balram, I don’t know if you have any questions you would like to ask to begin with?

Balram Ramesh
Sure, I will go ahead while we wait to collect questions. So on the guidance, Mr Mansour, you mentioned that you were reiterating your guidance of EGP 9.5 billion. It's a very nice position to be in, but do you think you are being very conservative if you look at your H2 2016 new sales? Effectively this implies that you will see a 7% drop in new sales in H2 2017. So can you just talk a bit about the guidance and what you see in H2 2017 in terms of new sales?

Yasseen Mansour
No, I agree with you. We had already increased our target after first quarter. I think it would be fair to say that we will definitely exceed the target. We have had a very good July and I think we would definitely exceed the EGP 9.5 billion. Probably we will be somewhere in the vicinity of EGP 10.5 billion to EGP 11 billion by year end.

Balram Ramesh
Yes. Thank you. One more thing in terms of the overall pricing environment and also the construction cost. It has now been six to eight months, more than eight months actually since the devaluation. Do you think we are likely to enter into a period of more normalised pricing on the top line as well as on the construction cost? Do you see these stabilising and at what levels do you see them growing, or do you still expect the double-digit increases that you've seen?

Yasseen Mansour
Well, what we expect is that interest rates should be gong own. If you look at month to month starting November we see the inflation figures going down from the 30s to somewhere in the teens. Having said that I think prices will be normalised. Price increases on construction will definitely normalise, although we know there will be another subsidy reduction on oil and oil products sometime towards June/July of 2018. This will probably affect our construction costs by another 5% to 6%. But we don't really foresee the huge increases continuing for the coming period.

Tarek Abdel Rahman
For construction. For actually real estate prices these are more a function of supply and demand. And we explained it before. There is a huge mismatch between supply and demand which has been driving prices up. We haven't reached that equilibrium yet because of the devaluation. And at least for 2018 we expect prices to be double digit, in the high double-digit numbers for real estate prices.

Yasseen Mansour
Double-digit increases.

Tarek Abdel Rahman
Double-digit increases in prices.

Balram Ramesh
Understood. Thank you.

Yasseen Mansour
One thing here I might add also is you know there is a huge difference between what we are selling at today and what our P&L says. So looking at the sales that we've done so far this year what we are measuring is our gross profit on new sales. So for the first quarter on our sales we had a gross profit of 37%. On the second quarter we had a gross profit on the new sales happening in the second quarter of 43%. So this will give you an indication what we are looking at into the future.

Balram Ramesh
Thank you. Chris, do we have any questions please?

Operator
Not at the moment, but ladies and gentlemen, again if you wish to ask a question please press star and then one.

Balram Ramesh
Just one more from my side. On the delivery, units delivered this quarter have grown by just 4%. You had consistently double-digit growth in the previous quarters. And you mentioned that construction is going quite strong, so is this seasonality or is it because of certain units being delivered in one go and a timing issue, or are we likely to see some slowdown in delivery in the second half of the year?

Yasseen Mansour
We are delivering as Tarek has said previously we are looking at about 1,600 units delivery this year. And the previous year we were over time to deliver a lot of units because we had a lag due to 2011, 2012 and 2013 issues that Egypt at large had and Palm Hills had also. So we were playing catch up. Today we are delivering what we promised the people we would deliver according to the contracts that we have.

Balram Ramesh
All right. Understood. Thank you.

Operator
We do have a question on the line from Deepak Tolani of Ashmore. Please go ahead.

Deepak Tolani
Hi. Good afternoon. Thanks for the phone call. Just a quick question from me. I know on the new sales you mentioned the gross margins are 37% to 43%. What is the trough margin for units that you are still delivering? My understanding is you've sold those properties two or three years ago. You are delivering those properties now. But the cost inflation has gone up on things that you have already sold, so that will impact your margins in the next few quarters. So what is the margin at the bottom of the cycle that you see right now?

Tarek Abdel Rahman
The thing is the ones that we are suffering a margin trough on have not been sold two to three years ago. They were probably sold somewhere around 2011 or 2012. Even before that, maybe even 2009, 2010 to 2012, and being delivered now which is what Mr Mansour was saying, the backlog that we were working through. If you look at whatever we sold over the last three or four years on a percentage of completion basis we are doing above 45% of profit margin. What is keeping the margin down is units that are being delivered now that we sold pre-2012 if you will.

Deepak Tolani
All right. Thank you.

Operator
Do you have any further questions, Deepak?

Deepak Tolani

I'm okay. Thank you very much.

Operator
Thank you. Balram, we have no further questions in the queue at the moment.

Balram Ramesh
Just a quick follow-up on the margin question. Do you see better margins for some of your commercial units that you have just started delivering in Palm Valley and Palm Central?

Yasseen Mansour
Yes definitely. On the commercial our gross profit exceeds 65%.

Balram Ramesh
Thank you.

Yasseen Mansour
In Palm Central it is 65% and in Palm Valley it is 84%.

Balram Ramesh
Thanks.

Operator
Thank you very much. Ladies and gentlemen, again if you wish to ask a question please press star and then one now. We have a question from [unclear] Sabodien [?] of Citi. Please go ahead.

Citi
Good afternoon gentlemen. Thank you for the call. A couple of questions from my end. First the structure of the real estate market. Clearly the economy is going through a lot of reforms in terms of lower subsidies and effectively lower money in the pockets of residents. I just want to get an understanding, what is the nature of the buyers' profile? Clearly your uptake in terms of sales has been impressive. Can we get an understanding of who is buying? Is it citizens living in Egypt or abroad? Just clarity on that. This is my first question. And my second question is on the pricing. Can you just give us some more highlights on the pricing trend that you've seen on your sales over the past 12 months? And finally do you get impacted… Clearly the economy is adjusting and we are seeing some cutbacks in terms of consumers trading down. Do you see this impacting your business? Is there more demand for mid-market offerings versus your luxury properties? If we can get an understanding on that it would be helpful. Thank you.

Yasseen Mansour
Okay. Just trying to answer your question, yes, we are seeing a big demand coming from Egyptians living abroad because as you can imagine for their Dollar-based income real state in Egypt becomes very cheap for them. We were at about 9% last year, 8% last year. Today we have more than doubled that from Egyptians living abroad. So we see this definitely as a part of the market that is boosting our sales. As we said we think we are gaining market share from competition. As we have talked about I think in hindsight what has happened after the revolution [unclear] today is in a way positive in the sense that our customers have much more faith and they are becoming much more careful with their choice of where to buy their homes. And don't forget that there is a huge gap between supply and demand in Egypt in real estate. So I think these three factors are fuelling the continuing of us doing pretty good and increasing our sales and increasing our targets every quarter.

On the pricing side very quickly by June we were selling the apartments at… Let me give you first of all our construction. Our construction increased from 2016 from EGP 3,200 to June 2017 EGP 4,300. So our construction cost per metre has increased by roughly EGP 1,100. We have increased our pricing in the same period on the built-up area from EGP 5,384 to EGP 9,100. So although the construction cost has increased also we were able to pass on an even higher increase on the built-up area to the customer. We nearly doubled it. Have in mind also that when you increase prices you increases prices on land and on construction, on both. Yes, your construction cost is increasing but your land cost is fixed. So that is why we see that our margin will continue to improve.

Citi
Just if I can add one small question, gentlemen, just on the payment plan. What is the structure of the payment plans you are offering? Has it become more flexible over the past few years or few quarters just to entice more demand and make it easier for customers to pick up properties?

Yasseen Mansour
In Cairo both east and west we haven't changed our pricing plans. We have launched a project in the north coast called Hacienda West. And there we have given ten years payment terms.

Tarek Abdel Rahman
For phase one.

Yasseen Mansour
For phase one. And the target is by phase two we are going to increase price and reduce the ten years to eight, then reduce it to six years.

Citi
Okay. And what is the payment plan on the projects in Cairo? What is the [unclear] and payment plan that you provide on a project currently?

Yasseen Mansour
It depends on the project but it varies anywhere from five to seven years. It depends on the maturity of the project. Let me put it this way.

Citi
For new projects, for newly-launched projects, new sales.

Yasseen Mansour
Okay, it is seven years with the exception of one project that we recently launched called The Crown. It is over eight years because actually we are paying the land over the same period, over eight years. We got a deal from the government to pay over eight years.

Citi
Thank you. That's clear. Thank you.

Yasseen Mansour
Thank you.

Operator

Thank you very much. Gentlemen, we have no further questions. Do you have any closing comments?

Yasseen Mansour
Thank you very much.

Operator
Thank you very much. Ladies and gentlemen, that concludes today's conference and you may now disconnect your lines.

Yasseen Mansour
Thank you so much. Thank you.

END OF TRANSCRIPT