Final Transcript

AUERBACH GRAYSON: Palm Hills Development Q1 2018 Results

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SPEAKERS

Adham Hesham
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PRESENTATION

Moderator: Ladies and gentlemen, thank you for standing by. Welcome to the Palm Hills Development Q1 2018 Results conference call. At this time, all participant lines are in a listen-only mode. Later, there will be an opportunity for your questions. Instructions will be given at that time. [Operator instructions]. As a reminder, today's conference call is being recorded.

I would now like to turn the conference over to Adham Hesham from Beltone Financial. Please go ahead.

Adham Good morning, good afternoon, everyone. This is Adham Hesham from Beltone Financial. I would like to welcome you all to PHD's First Quarter 2018 Results conference call. From PHD we have with us Mr. Tarek Abdel Rahman, the Co-CEO; Mr. Ali Thabet, the CFO; Mr. Mamdouh Abelwahab, investor relations and investments AVP.

As usual, the conference call will begin with a discussion of the key highlights of the first quarter followed by a brief Q&A session. I will now hand the call to Mr. Tarek Abdel Rahman. Thank you very much.

Tarek Thank you, Adham. Good afternoon, ladies and gentlemen, and thank you for joining our first quarter of 2018 earnings conference call. On today's call, I'll briefly present to you the key financial highlights for the quarter. Then, we'll open the floor for questions as usual.

We are happy to announce that the company has beat all market consensus of all matrices coupled with the strong profitable growth across the board. The highlight of this quarter, we would like to say is the expansion in the margin we are seeing on all metrics, which is part of the company's strategy focused on profitable growth and improvement in our return on equity.

Gross profit margin increased 37% from 31% in Q1 2017 with an improvement of 6 percentage points. EBITDA also showed improvement of 6 percentage points to 26% from 20% over the same period last year. Our net profit reached 15% up from 13% a year earlier.

Our financial results continue to reflect our operational excellence with revenue 1.5 billion, gross profit 547 million, EBITDA 381 million, and net profit 224 million. The revenue was relatively flat compared to Q1 2017 due to we handed over less units this quarter of 301 because our target is 1,500 whereas we handed over 418 units in the same quarter last year.

Gross profit increased by 12% to $547 million, and as I mentioned with improvement of 6 percentage points in the margin to 37% with EBITDA also improving from 20% to 26% and recording 281 million. The improvement in both is due to the handing over of units in Golf Views and Hacienda Bay mainly along with several other older projects, and these are units that were sold in 2014, 2015 when we started increasing our prices aggressively, and we are now feeling the improvement in margin.

Net profit after tax, grew by 6% to $124 million due to lower minority interest, but also due to the trickling down from the gross profit and EBITDA improvement in margin. Our balance sheet continues its strong position with the receivables of nearly 16 billion covering our net debt of 4.2 times. Net debt to EBITDA recorded 2.4 times down from 2.7 times.

We also concluded securitization issue this quarter in May 2018 in line with the deleveraging plans. We received net proceeds of 261 million. We were aiming to do securitization of 700 million, but we opted to do half that number in the first quarter and divide it over two tranches because we faced delay because the board of the [indiscernible] financial authority was not confirmed until later in the quarter, and they were reviewing all the—they couldn't approve the issue before they were confirmed, so we opted to make it simpler for them and go with the smaller issue. They are now preparing for a 400 million issue to be done either this quarter or next.

We'll continue to closely monitor our construction. We've achieved the construction for 500 million this quarter. Our core commercial assets contributed 16% of net profit in line with our plan to generate 25% of our net profits from recurring income and commercial assets.

On the operational front, new sales was relatively slow year-over-year during the first quarter of 2018. This is due to things related to the company and conditions not related to the company. Related to the company, we had a very strong quarter in Q1 2017 as we had the launch of Palm Hills, New Cairo. We had no new launches in the first quarter of 2018. We're also preparing for the launch of the 3,000-acre or 3,000-feddan project called Bedia [ph], and this has taken a lot of bandwidth from the company.

We've also witnessed a slower market due to many different launches from many smaller developers, especially on the east side of the city in the new capital and in Mustaba [ph] City.

New sales amounted to 2.1 billion in first quarter of 2018 of which residential new sales amounted to 1.9 billion. We commenced sales in Palm Hills Medical in West Cairo and witnessed an uptick in demand for commercial users in the Lane in North Cairo recording 55 million and 159 million respectively.

Looking into the regions in which we operate, the star of the quarter was East Cairo with new sales amounting to 1.2 billion driven mostly by Palm Hills, New Cairo and Capital Gardens.

It's worthy to note that Palm Hills, New Cairo since inception had recorded sales of 5.4 billion Egyptian pounds. West Cairo was the second largest-selling district with sales recorded 855 million led mainly by the Crown and Palm Parks in addition to Woodville and the commercial units sold in the Land and Palm Medical. Those residential sales with the 642 million with the balance being commercial sales in the Lane and Palm Medical.

The North Coast has very low new sales which is normal due to the seasonality factor. We're looking to achieve the majority of our sales in the North Coast in the next quarter.

The company handed over 201 units during the first quarter 2018. We are on schedule to deliver 1,500 units by the end of 2018. Construction activity for the quarter is progressing largely as scheduled with earned value of 500 million pounds in the first quarter.

In terms of outlook for the rest of 2018, we're currently discussing a number of potential partnership agreements for ventures in Bedia project addressing educational, technological, and retail fronts. We also have the launch of the first phase of Bedia during this quarter. We haven't released any numbers, but we'll be happy to answer your questions as long as we don't have to divulge any numbers.

We are also active in discussions with the leading operator of commercial real estate to co-develop a new commercial concept in Palm Hill, Cairo. With regards to the 205 feddan, which we co-bid on with Arkan [ph], we are expecting to reach a definite agreement during either this quarter or next with the government.

With that, we're happy to open up questions to participants.

Moderator [Operator instructions]. Our first question is from Athmane Benzerroug from Deutsche Bank. Please go ahead.

Athmane Good afternoon, gentlemen. Just a quick question on the margin trend going forward. After the increase that you had for this quarter, can you quickly [indiscernible]. My question is on two or three years down the line, which kind of gross profit margin are you expecting, and even a range if possible?

Tarek Sure. So, you're asking about margin trend, construction costs, and gross profit margin over the next three or four years, correct?

Athmane Yes.

Tarek Okay. On the market trends, we have seen a number of new participants enter the market. While we are not concerned about the supply and demand dynamics, we feel because the market is still way undersupplied, but we have seen a number of small participants enter the real estate market, especially on the east side of town. What is alarming is that they have bought plans extensively north of 3,000 pounds over a short period of time. They're paying it over four to five years, and in some instances a bit shorter, and they're offering extremely competitive pricing with very long repayment tenors.

I think this is a worrying trend because we don't see how these people will be able to fund themselves going forward, which makes a certain market disruption. This is mainly in Mustaba City in the new administrative capital. We think that this trend may continue and it started maybe a quarter or two quarters ago, and may continue for a quarter or two, but then they will have to increase their prices significantly and lower the installment period if they want to continue.

This is exactly, Athmane, why we opted to do rating initiating agreements on all the new land deals that was taken, so if there's any disruption in the market, we don't have large fixed land installments to pay.

On the increasing construction costs, construction per meter squared now is hovering around the 4,200 pounds per meters squared. We think there's another increase coming in the latter half of the year after they remove the subsidy on the gasoline or on the energy in general. We expect it maybe to increase to north of 4,500 pounds. I think this will be the last major jump for the time being. We expect total construction increase this year, maybe of 10%.

On the gross profit margin going forward, our gross profit like you've seen improved from 31% to 37%, I think on the long term, we think it's going to stabilize maybe around 42%, 43% over the coming three to four years.

Athmane So, you expect the margin to strengthen going forward.

Tarek Yes, we expect the margin to improve going forward. Remember in 2014, 2015, and 2016, we had very aggressive price hikes, and apartments we recognized revenue upon delivery, so we should see that flowing into our results over the coming two to four years.

Hello?

Moderator You're still connected.

Tarek Yes, we are.

Moderator Did we lose Athmane's line, or are we onto the next question?

Tarek Sure.

Moderator Okay, we'll move on. We'll go to Marwan Adel with Ostoul. Please go ahead.

Marwan Hello, everyone. My question is regarding the new project Oasis Bedia. First, when you signed the contract, you announced the total sales from the project is 180 billion while in your last announcement you mentioned that the total sales from the project is 480 billion. So, where is the difference coming from? That's the first question.

The second question, are you opening the new project for sub-development, or are you going to take the project full on? Thank you.

Tarek I think the 180 billion that was mentioned during the announcement, it was meant to be the investment costs, not the total revenues of the project. I think the revenues are closer to 450 billion. Remember, we just finalized the master plan, so we have a very, very accurate number of the amount of units that will be sold and built, which is close to 42,000 units, of which 37,000 will be apartments with the balance will be standalone units. The number is closer to the 450 billion, which the 180 billion, I think at the time was mentioned as the investment cost of the project.

In terms of whether we will seek co-development or development by ourselves, I think eventually, we will seek co-development in the project, but for the coming probably three to four years, any co-development will be done on the commercial real estate front rather than the residential real estate front, and we think for the coming three to four, maybe five years, all residential real estate will done directly by the company, and then we will re-assess again, the reason being that we need to create a destination, and I don’t think there’s a better name we can partner with—I mean, there’s a stronger name in residential real estate than Palm Hills, so there’s no need at the moment to partner with a residential real estate developer.

However, on the commercial real estate, you may find us co-developing with prime names in commercial real estate, whether it’s office, mixed use, education, entertainment.

Marwan	Okay, and does the 480 billion in sales include only the residential part, or is it the commercial as well?
Tarek	Only residential.
Marwan	Only residential. Alright. Thank you very much.
Tarek	You’re welcome.

Moderator [Operator instructions].

Adham If I may, this is Adham from Beltone. I have just one question on the non-residential inventory. What's the targeted non-residential inventory to be launched during 2018, and the expected gross margins upon recognition? Thank you.

Tarek The expected gross margins I'll answer it first. The expected gross margins are more like 60%, maybe higher. On the expected launches, we expect to launch the rest of Palm Medical—hang on. We expect to launch the rest of Palm Medical and the Lane and maybe a project in East Cairo. We will circulate the numbers. I don't have them in front of me, but I think our total commercial project sales to date are about 208 million. I think we will be looking at another maybe 400 million or 500 million this year.

Adham Another question, do you expect to see any slowdown in sales in East Cairo given the intensifying competition from the new capital of Mustaba City?

Tarek The two projects that we have in East Cairo which have any sort of meaningful inventory to sell are Palm Hills, New Cairo and Capital Gardens. I don't think Palm Hills, New Cairo is going to face any slowdown. It is sort of positioned as a premium project, hence we use the Palm Hills name on it. We are going to sign during this year a number of agreements with many commercial real estate players on a co-development basis to actually make it a destination. We will start building the country clubs, so I don't see it slowing down.

In both projects actually construction has commenced, so that's a big positive for consumers when they come to buy. I think Capital Gardens may face more competition than Palm Hills, New Cairo because it's positioned as more of a lower sort of tier project, which is similar to what is being launched now, however, our construction is ahead of schedule, so this is a big positive for this project versus the competitors.

Adham Okay, one last question regarding Capital Gardens because I know that phase one was sold at very competitive prices, but again you commenced construction post-rotation. Do you expect that to pressure margins because you just gave guidance of margins ranging from 42% to 43% going forward?

Tarek — Yes, we expect Capital Gardens for phase one the margins will be much more squeezed than they are for the rest of the projects because of exactly what you said.

Moderator — We have no other questions from the phone lines. You may continue.

Tarek — Okay, I think if there are no other questions, thank you very much for everybody who participated in today's call, and we'll see you next quarter.

Moderator — Ladies and gentlemen, that does conclude your conference for today. Thank you for your participation and for using AT&T TeleConference. You may now disconnect.