Palm Hills Developments
4Q2017 Earnings Conference Call Transcript

Operator: Ladies and gentlemen, welcome to Palm Hills Development conference call. I'll hand over to your host, Mr. [Imad Elhajj 00:00:09] from Arqaam. Sir, please go ahead.

Imad: Thank you, operator. Good afternoon everyone and welcome to the Palm Hills Development's fourth quarter and full year earnings conference call hosted by Arqaam Capital. This is your host [Imad Elhajj 00:00:22], real estate analyst at Arqaam Capital Research and I am joined by Mr. Yasseen Mansour, the chairman, Mr. Tarek Abdel Rahman, the Co-CEO, Mr. Ali Thabet, the CFO and [Mr. Mamdouh Abdelwahab inaudible 00:00:35] the IR and investments director. Without further delay, I would like to hand over to Mr. Yasseen Mansour, the chairman of the company.

Yasseen: Thank you, Imad. Good afternoon ladies and gentleman and thank you for joining our full year 2017 earning conference call. On today's call, I will briefly present to you the key highlights for the year, 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.

Despite the challenging operating environment and market conditions following the flotation at the end of 2017, we realized several major milestones on top of which are the following: the company beat all its previously announced guidance and financial target for the full year and exceeded market consensus and analyst estimates.

From stability margins, we've witness improvements across the board, mainly in gross profits and [inaudible 00:01:31] the margins of 32% and 20% respectively, a net profit margin of 12%. Our financial results continue to reflect our operation and excellence highlighted by an all-time high new save of 12.5 billion Egyptian pounds, which was driven by not only growth in selling prices but also the number of units sold.

The gross profit margin in 2017 [inaudible 00:01:58] is currently estimated at 42%, which should be reflected in P&L statements of the future reporting teams. We believe our market chair continued to grow with 2,136 units sold throughout 2017.

The revenue of the year increased 17% year over the year to reach 6.6 billion Egyptian pounds, which reflected positively on net profit recording and 806 million after tax and minority interest with growth of 26% year over year.

We handed over, as I said, 1,781 units, spent 2.1 billion on construction and generated cash flows from operations of 4.6 billion Egyptian pounds. Looking in to the balance sheet, it maintains a solid position with the receivable increasing and reaching 15.3 billion, covering net debt 4.3 times.

We concluded that securitization and discounting of receivable transaction for 629 million. We could have done much more, but we opted to wait until the interest rate environment improves in Egypt, which already started to happen with the recent division of the Central Bank of Egypt to cut rates and [inaudible 00:03:17] as inflation eases up year on year.

In 2018, we are planning to conclude securitization transactions for anywhere from one and a half to 1.8 billion Egyptian pounds, including 700-800 million that we expect to close during the first quarter. The transactions received will be used to repay our existing debt as part of our commitment to deleverage the balance sheet through the securitization of receivables program.

We successfully finalized negotiations with local banks and were able to reduce interest rates applicable to 75% of the company's debt, helping us to save 100 million pounds in the during the tenor of the loan.

We completed construction work in a number of projects: Casa, village gate, Village Avenue, Village Gate of [Katameya 00:04:11] and Hacienda White, too, in line with our plans to conclude all projects currently under development.

We signed a definitive co-development agreement of Palm City spreading 3000 feddans in West Cairo, with the first phase to be launched in April, 2018. As you know, we have been negotiating this project with [Newca 00:04:38] for almost two years, so I'm quite pleased with this achievement. We finalize the master plan of the first stage spreading around 850 feddans. This phase will offer 12,018 units.

We just finalized the details with our advisors in Germany this last week, and we are currently in the final stages of selecting architectural types of units to be launched within phase one A. Phase one A will spread on 352 feddans, including 126 feddans of residential development, roughly around 3, 00 units.

We commenced motorization of none-core commercial assets and generated sales of 661 million during the year 2017 from the project delay Palm Central and Village Gate of [Tamayamor 00:05:34].

We estimate that we will be selling commercial at its worth, roughly five billion Egyptian pounds over the coming 24 months with a gross profit margin of 50%. This does not include the 205 feddans in West Cairo that we have co-bid on it with [Bedradim 00:05:55] they are the developer of one of the largest of commercial space on the west side called [Arquan 00:06:02] complex. This land is strategically located on the 26 of July [inaudible 00:06:09] with 50% footprint allocated to commercial use.

We continue to closely monitor our construction costs, which as you're aware increased 29% 2017 more than 2016. In comparison to our selling prices, which recorded a year on year growth of 41% for the land, 51% and 39% for picked up area standalone units and apartments, respectively.

Our core commercial assets, the three hotels that we own and Palm Hills club in West Cairo contributed 14% to net profits in the 12 months of 2017, in line with our strategy to generate 25% of net profits from recurring income and commercial assets by the end of the year 2020.

With that I will hand over the call to Tarek to walk you through the financial results of 2017.

Tarek: Good afternoon everyone, and thank you for joining the call. Like Mr.Yasseen has said, let me reiterate. We have closed the year with 10.5 billion of sales, a growth of 24% over 2016 and the highest in the company's history.

This year we realized significant saves from commercial assets. We explained to many of you as we said before that our non commercial assets were earmarked for selling, and we sold commercial assets worth nearly 662 million Egyptian pounds, which residential sales amounting to 9.8 billion Egyptian pounds.

With a very healthy mix between existing projects and new launches, we are in a very good position of actually having projects that are coming to completion who cater to people who are very keen to live with in a period of maybe 12-24 months and projects that are in the launch phases, which offer exciting new products to our clients.

We're one of the very few developers in the market to be able to offer both kinds of products, one that will be complete within 12-24 months and another, which is in the launch phase. It is worth to highlight that our sales to Egyptian's living abroad increased from 8% in 2016 to 18% in 2017 because we the evaluation, it became attractive for Egyptians living abroad to buy real estate assets here in Egypt.

In terms of units sold in 2017 our volume grew 13%. We sold 2,136 units, up from 1,894 units, which is very good in a year where consumers were squeezed due to inflation and devaluation and removal of the subsidy, we were able to increase the number of the units we sold and while we don't have accurate estimates, we think we are increases our market chair in the market overall.

Since the beginning of the year I will add that selling has increased by 51% for [inaudible 00:09:29] stand-alone units and nearly 40% for apartments with land for stand-alone units increased by nearly 40%. Construction cost also increased by nearly 30%. Our current construction cost per meter is around 4,000 pound mark.

Looking in to our income statement, we continued our steady focus on enhancing the company's responsibility while maintaining the quality for which we are well known, which translates into probability margins improvement. Revenue for the year grew 17% to 6.6 billion, we handed over 1,781 units, which contributed to the increase in revenue. 56% of the handed over units were Hacienda Bay, Village Gate and [inaudible 00:10:17] extension.

We also recognize on the percentage of completion basis for standalone units, which we sell during the current year.

Gross profit for the year increased to 2.1 billion, a growth of 25%, and a margin of 32%, which is an improvement over the 30% margin witnessed in 2016. [inaudible 00:10:41] revenue stood at 11.5% a decline of 0.3% from 11.8% in 2016 and continues to decrease as the percentage of new sales to 7.2% from 7.8% in 2016 despite us doing significant salary reduction to employees at the beginning of 2016 to counter the inflation, which the entire country witnessed. Even our margin grew 33% to 1.3 billion and an improvement in the margin from 18% in 2016 to 20% in 2017.

Net profits [inaudible 00:11:20] tax and minority grew by 26% to reach 806 million, and let me point out that this is despite [inaudible 00:11:27] of 116 million due to the sector securitization, where we all know that when we do a securitized bond, we have to realize the entire interest in the year of [inaudible 00:11:40].

Bottom line was supported by the growth in [inaudible 00:11:42] segments, revenue as a part of Palm Hill's state in [Mahoor 00:11:47] where the segment 57% to 63 million Egyptian pounds.

In fourth quarter 2017, revenue slightly decreased to 1.8 billion due to a change in the [inaudible 00:12:00] with a lower hand over of 441, mind you because we hit our target we have slowed down intentionally in the last quarter as well because he hit the targets that we had previously communicated of 9.5 billion.

Net debt to [inaudible 00:12:17] stood at 2.6 times as far 2016. While we hope to decrease it, due to securitization, we intentionally postponed the securitization issue to the first quarter of 2018 because we were anticipating an interest rate decline, which actually happened and let me tell you that securitization is the price of [inaudible 00:12:39] which witnessed an even more decline in interest rate than the 1% affected by the Central Bank of Egypt.

With that and with these great results, we would like to open the floor for any questions.

Operator: Ladies and gentleman, we will now start our Q&A session. If you wish to ask a question, please press 01 on your telephone keypad. Thank you for holding, and we have our first question.

We have a question from [Al Husein Kareem 00:13:23] from RWC partners. Please go ahead.

Al: Hi everyone, congratulations on the great numbers and thank you for the call. I have a couple of quick questions. You've mentioned that in the first quarter 2018 you're going to do 700 to 800 million Egyptian pounds securitization of the receivables. How much would you guide for the full year and now interestingly we've seen the recent cut, how many further cuts you anticipate in interest rates on that and what is the discount you're expecting to get on these [inaudible 00:14:02]?

The second question is if you can elaborate on the free cash flow and the cash flow from operation and your view for 2018 versus 2017 in the fourth quarter.

And lastly on the guidance, it seems your 2018 net income guidance is flat, is that a conservative guidance given that you said you're going to make further profits from deleveraging and from restructuring the debt that you have to lower interest rates? And thank you again.

Yasseen: As far the expectation on interest rates reductions that will happen, we figure there will be another 2-3% reduction in 2018. We're hoping that the first of these will be in the meeting on the 29th of March 2018.

With regards to the securitization, we think that the issue is that we'll do during Q1 is between 700 to 800 billion Egyptian pounds, the good thing is that the price of the T bill rates, the discount that will be used fight these securities will be less one and half percent over the T bill rates, after tax, which is about 14 and a half, so we're talking about a discount rate of 16%. They take the receivables and discount them by 16%. Again, we're paying 1.75% above the [inaudible 00:15:46] rate, which is 18 and quarter now, so not only does it help us deleverage but it's help us to save interest rates albeit the accounting hit.

For the guidance, we guide the net profit of 800 million. Yes, we think it is a conservative guidance, we usually start the year with a conservative guidance mind you we are also in a stage in the company's life cycle where the amount of units to be handed over from the old project is not many and the amount of units to be handed over in the new project is basically zero because we've just opened up sales, so from an accounting point of view, the amount that we realize will be 10 million the sale of stand-alone units and percentage of completion of construction rather than the other two because all projects are coming to completion and the new projects we still haven't handed over any apartments in them yet.

Al: And on the operating cash flow, we know you've been running your negative cash flow model to deliver the legacy units and now you're done or almost done, how do you view the operating cash flow in the first quarter and how do you see it from here?

Yasseen: We think that in 2018, we'll turn the [inaudible 00:17:18] cash flow from operation model. This ... And to the tune of 500 million Egyptian, so the free cash flow to the tune of 500 billion Egyptian pounds after the payment of debt and before taxes we are very confident that we will be able to achieve that this year, having achieved cash inflow from operation in 2017 of 4.6 billion, that's the cash in-flow at an improvement of 51%.

So we are on track from our receivables and from our [inaudible 00:18:01] to become free-cash flow positive in 2018 [inaudible 00:18:08].

Al: Thank you so much.

Yasseen: You're welcome.

Al: And sorry, if I can ask a follow up, given that entrance rates is going down, at what threshold do you think the demand will materially increase?

Yasseen: The demand on real estate you mean?

Al: Yes, let's say now the interest rates around the 18 level, it may go to the 15 or 14, do you demand will really get a strong [crosstalk 00:18:38]

Yasseen: We figured it's an estimate that basically, if it drops another 3%, we foresee something like 150 to 180 billion increase in real estate in Egypt.

Al: Perfect, thank you so much.

Yasseen: Thank you.

Operator: Our next question is from [General Millen 00:19:05] from Arqaam capitol. Please go ahead.

Speaker 7: Good afternoon gentleman, thank you very much for taking the time for the call. Could you please comment a bit more on the 3,000 feddans project? What kind of revenue share agreement is it, and how many units do you expect to launch in the first stage or in 2018, and then again in 2019, how many units, size expected, how do you expect to price it?

And are you concerned that launching that many units, or with you guys launching so many units, and several of the other major players also launching somewhat of a mega-project, that you could reach a point where you won't sell everything within the first couple of years and you might oversupply the market temporarily for a few months or for a year?

Yasseen: Okay, thank you. No, the 3,000 feddans, we have run different models, we have also used [Bakenhof Mackenzie 00:20:10] to model it on a separate [inaudible 00:20:13] sensitivity and the way we're forecasting is the market absorption, so we looked at what we feel the market absorption would be and we've reverse engineer the business plan according to that.

As we mentioned, we finalized the design, the master plan, we finalized and freezed the design for phase one A, that's 323 feddans. This is roughly around 3,400 units or something, that's the first phase that we will be launching in April this year.

Now, having said that, you've mentioned the crowding and the market and the launches. This plot of land is the west of Cairo, and this was one of the main reasons that we chose this land to the west side of Cairo is because there is less supply on the west than on the east. This plot of land gives us the advantage of being able to penetrate the market at much lower prices than what we are selling today.

Having said that, we're looking at selling the apartments for roughly around 9 to 10,000 Egyptian pounds. For the apartments, this will be our selling price, and for the villas we're looking at we'll sell the land at roughly 8,000 pounds and the [inaudible 00:21:48] area on that land at around the same price, at around 8,000.

Now, what is the agreement with the government on that land? It is a 26% revenue share, they get 26% through and [inaudible 00:22:04] but having in mind that basically what they're getting is 25.2 billion Egyptian pounds roughly over 12 years. That will give them a total price of 2,200 pounds per meter and over the tenor of the [inaudible 00:22:25]. Basically, the agreement with the government that the land is priced at 640 Egyptian pounds per meter at NPV, at net present value per meter at a discount rate of 16%. So if you multiply 3,000 feddans by 4,200, that's roughly 12.6 million square meters. If you divide the 25 billion, divide by 12.6 it would around 2,000 pounds [inaudible 00:22:56] to today's value to be 640 Egyptian pounds, plus their getting [inaudible 00:23:01] area of roughly 375,000 meters in a residential and 50,000 of commercial space.

In a nutshell, the agreement, because the land is [inaudible 00:23:20] for example [inaudible 00:23:23] is today, that's why the land is at the cheaper price. I hope I answered your[crosstalk 00:23:32]

Speaker 7: Yes, you did but just to clarify, 9,000 to 10,000 pounds per square meter is what you're selling?

Yasseen: Yeah, apartment [crosstalk 00:23:43] selling price.

Tarek: Yeah, that is well below the historically at least in the past year or so, the prices you sold for the apartments that are closer to the center. So that's our selling point, that it's pretty much very cheap compared to others.

Yasseen: Exactly. We want to penetrate the market there, but our strategy, we're going to start our selling strategy only we'll start it with our client list as to give them preferential treatment in getting these prices, and then we will move on to the market after that. So we will start with a soft opening in April, and then we will follow that with the main launch will be in September or October. We figured that our target is for the soft opening, we will be selling somewhere around two billion Egyptian pounds.

Tarek: And these will be at free-cash or a cross-profit margin of well below 40%, just because you're still at the lower end maybe in the low 30's. So, after we deduct 26%-

Yasseen: Exactly. That's usually how it's done, you start at the lower GP and then you take it up with more construction on-site, with more amenities, we're looking at having university schools, shopping centers, we're having a lot of new ideas that would be implemented in this city.

Tarek: Mind you, our main material in any real estate project is the land. And here the land is at a very competitive price, which allows us to start selling at competitive price as well to penetrate the market. So this is the main idea behind, like we explained to many of you, we did these revenue sharing deals with a cap to the government when nobody else was bullish about Egypt and nobody else wanted to buy land, and we think we're sitting in a very good position with regards to these deals the land prices simply because we did them at a time when there wasn't much competition among real estate players in acquiring land from the government. And this is by far the most competitive of them, because of the size of the land and the location being slightly more removed from the center.

Yasseen: So basically, if you look at the land it's priced at 640, where we are in Palm Hills to the west, if you're buying land in east you'll probably buy it at 2,800.

Speaker 7: Okay, okay so at this lower land cost, you're basically passing on almost entirely to the customer and you probably start off with a gross profit margin of low 30's, 30, 33% what not, but as you gradually build more of these units you'll probably raise the price further and then go all the way up to 40, average it out, 35%.

Yasseen: Yeah, it's probably more than 35, we averaged throughout the year it will probably be more than 35%.

Speaker 7: Okay, and I'm guessing that this would be it for the projects that you're looking for west of Cairo, beyond that you'd probably be looking for where for example?

Yasseen: No, we have bid for another plot of land as I mentioned, which is 205 feddans on the 26th of July corridor, it's the most commercial appealing street probably in all of Egypt next to street 90 on the east side, that's the most appealing street as far as commercial. This plot of land of 205 will be done, we have bid in a JV, in a joint venture with the people that have developed Arqaam [inaudible 00:27:43] and office space, which is mainly a commercial recurring income more to the west side, to the most successful [inaudible 00:27:50], we have bid together.

This land has the ... it's unique in the sense it is 50% residential, 50% commercial. We feel this is an area, this will give us a huge edge and this is where we can really have commercial presence and increase our recurring income. This will, for us, would be a turning point in that sector.

Adding to that, we have agreed with the Arqaam people we should be announcing any time soon actually, that they would move and we'd Arqaam east so they would come with us to our project [Farm Hills 00:28:32] new Cairo and will open the same development as the one that's here, to be called Arqaam East and they will also come in with us into Palm City once it is launched.

Speaker 7: Okay, excellent. Alright, well thank you very much for your time. Thanks.

Yasseen: Thank you.

Operator: We have a follow up question from [Al Husein Kareem 00:28:59] from RWC partners, please go ahead.

Al: Hi again, I thank you for-

Yasseen: Sorry, no, we can't hear you.

Al: Can you hear me now?

Yasseen: Yeah, yeah, now.

Al: Okay sorry.

Yasseen: Yeah, yeah.

Al: Thank you again, I think you partially answered the question that I wanted to ask was the lower prices on this new project versus lower prices on the land while we assume the cost is going to be the same, so you still anticipate good margin, you don't expect your growth margin to be diluted by these new projects?

Yasseen: No.

Al: No? Okay.

Yasseen: At the end it balances out. If you look at for example on our legacy projects today, we're grossing 65 and 75% of some of them because at the end, the price of land is fixed.

Al: Yeah.

Yasseen: So basically at today's prices, you look under the placement cost basis, so then we will start a little bit around the low 30's and then hopefully we can take it up to maintain our target, which is 42 to 45% moving forward.

Al: Okay, thank you so much.

Yasseen: Thank you.

Operator: We have no further questions. Ladies and gentleman, if you wish to ask a question please press 01 on your telephone keypad. Thank you for holding until we have further questions.

We have a question from [Muhammed Halij 00:30:51] from the DIC investments. Please go ahead

Muhammed: Hello, this is [Muhammed Halij 00:30:59] from DIC investments. I just have a quick question about the new project that you are planning to launch, which is the Cairo west, how long will it take for the project to materialize or for the project to be completed? Thank you.

Yasseen: It will take around 12 years for the entire project to be completed, but stage one for example, you'll be handed over after four or five years after launch. This is a 3,000 or 12.6 million square meter project, so it will be spaced out very, very finely and some phases will be living within the coming four to five years, while other phases will start living in 12 years time.

Muhammed: Okay, thank you.

Operator: As a reminder, ladies and gentleman, if you wish to ask a question please press 01 on your telephone keypad. Thank you for holding. We have no further questions. Speakers, back to you for a conclusion.

Yasseen: Okay, thank you very much. If there are no further questions, I think that's it so thank you again for joining our call and looking forward to a good 2018 [inaudible 00:32:32]. Thank you.

Imad: Thank you everyone. Thank you.

Yasseen: Thank you, bye.

Operator: This concludes today's conference call. Thank you all for your participation, you now disconnect.