Inchcape
Q1 Results Conference Call

Duncan Tait

Group CEO

Good morning, everyone, and thank you for joining us. With me on the call is our Acting CFO, Adrian Lewis and our Head of Investor Relations, Raghav Gupta. I'll begin by commenting on the Group's performance and outlook, before handing over to Adrian who will give more detail. We'll then take your questions.

As detailed in this morning's announcement, the Group's Q1 performance has been excellent, with continued strong business momentum reflected in our strategic, operational and financial progress. In the first quarter, we reported revenue of £2.7 billion, with growth of 50% on a reported basis, reflecting the benefit of M&A, including Derco. On an organic basis, revenue grew 13%, with a continuation of the trends experienced at the end of last year and growth across all regions.

The M&A contribution was primarily driven by the consolidation of Derco, which has made an encouraging start in its first quarter within the Inchcape Group, while our other recent acquisitions, Morrico in Guam, Simpson Motors in the Caribbean and Ditec in Chile, all continue to perform well.

On Derco, I am especially pleased with the progress to date in integrating the business into our Group and we remain firmly on track with our strategic and financial plans. We reiterated our confidence in our margin expectations for Derco at our full year results and we stand by our expectation of delivering operating margin towards the top end of the 5% to 7% range that is typical for a distribution business before the impact of synergies.

Adrian will touch on inventory shortly, but from my perspective the team have done a great job in aligning inventory management practices in Derco with those employed across Inchcape. I was in the Americas visiting the operations a few weeks ago and I'm confident about the working capital opportunities we have quantified for 2023.

Finally, in relation to EPS accretion from the deal, we continue to expect at least 15% accretion in 2023 and at least 20% in 2024. This reflects the additional profit contribution and the dilution from the Inchcape shares issues to Derco's former owners.

Over the past few years, we have continued to shift the Group's portfolio towards distribution and during the first quarter we have further extended our distribution footprint. I'm delighted with the speed at which our team has expanded our presence in the APAC region, firstly with the agreement to acquire CATS, giving us access to the Philippines, adding another exciting and high growth market to the Group.

And more recently, the agreement reached with Mercedes-Benz for us to purchase their operations in Indonesia, a business the OEM has been operating since 1970 and has now decided to handover to Inchcape to manage and drive further growth. The two acquisitions will collectively add over £320 million of annualised revenue and we anticipate completion during the second half of 2023.

We were also pleased to be appointed the distributor of Tata commercial vehicles in Thailand, broadening our footprint in a market where we already distribute JLR. This expansion is a great example of our accelerated strategy and actions delivering on the Group's growth ambitions.

The combination of our broad market footprint, strong OEM relationships, our digital and data capabilities and our robust financial position continues to make Inchcape the natural consolidator in a highly fragmented industry.

During the quarter, we continued to progress with our ambition to capture more of a vehicle's lifetime value by our bravoauto and our digital paths platform. In these early days, our teams are focused on execution and we are pleased with the progress so far.

Now moving to outlook, following an excellent start to 2023 and based on prevailing market conditions, we expect to make strategic, operational and financial progress, underpinned by the integration of Derco, with full year results expected to be in line with published market consensus. Adrian, over to you.

Adrian Lewis

Acting CFO

Thank you, Duncan, and good morning, everyone. In Q1, the Group generated revenue of £2.7 billion. On an organic basis revenue grew 13% with growth across all regions. Duncan references the significant M&A contribution driven primarily by Derco and currency also provided a small tailwind. Overall, on a reported basis, revenue increased 50% year-over-year.

Looking at our two segments, in distribution revenue increased 70%. The M&A impact largely reflects the consolidation of Derco, although Simpson Motors and Ditec, both acquired in Q2 2022, also supported growth. On an organic basis, distribution revenue increased 15%, supported by improving new vehicle supply and aftermarket growth.

In retail, revenue grew by 8%, with performance also supported by improved supply. The growth rate was stronger on an underlying basis, with the headline impacted by the switch to agency for certain brands at the start of 2023. Now let me provide you with some further detail.

Starting with the Americas, we saw good performance despite several markets lapping challenging comparators, where share gains for several brands that were supply constrained during 2022. Elsewhere, the aftermarket continued to grow, with the bravoauto rollout in the second half of 2022 driving greater used vehicle revenue in Q1.

Moving to APAC, performance in both Singapore and Hong Kong was in line with our plan, with an improvement expected in late 2023. The reopening of the border with China has led to increased order books in Hong Kong. Our other markets in Asia continue to see strong trading, with a continuation of the trend seen over recent time. In Australasia we continued to see a strong momentum, underpinned by improving vehicle supply and a long order book and our bravoauto business is gaining traction.

In Europe and Africa, in Europe we saw double-digit growth in both new and used vehicles, supported by better vehicle supply and a particularly strong performance from Romania, Greece and Bulgaria. Whilst it's early days for bravoauto, the business is progressing well. In Africa, our performance was underpinned by a robust aftermarket.

Before we move to retail, I'll provide you with an update on Derco. Derco's first quarter revenue and profit performance was in line with our expectations. In terms of market performance, the new vehicle volumes in both Chile and Colombia declined versus the prior year following a strong 2022, but Peru and Bolivia saw strong growth.

In terms of brands, we saw strong performance for certain brands across both Derco and core Inchcape following improved supply and this was offset by normalising market share elsewhere, following a very strong performance in 2021 and 2022. The aftermarket business was also performing well.

As part of our integration plan, we have prioritised the alignment of our inventory management practices with those employed across Inchcape and we've been working in collaboration with our OEM partners to revise down previously agreed orders for vehicles and parts and I am pleased with the progress the team has made so far.

At completion, Derco's inventory balance was £200 million higher than we had anticipated and as we have said at our full year results, we have identified this as a working capital opportunity that we will deliver on through 2023. This will be partially offset by a working capital outflow across to the rest of the Group, as that part of the business normalises. Overall, as Duncan said, we are pleased with the progress we have made with the integration and performance to date.

Moving to retail, revenue grew 8% year-over-year on an organic basis, with the underlying performance much stronger after the adjusting for the impact of the agency model. That change in business model will have a negligible impact on profit and as a reminder, the shift to the agency model will not impact our distribution business.

Performance has been driven by growth across all our revenue streams, with higher new and used vehicle volumes and aftersales growth. New vehicles underpinned by higher volumes, used vehicles supported by a more established bravoauto business. So overall, the Group has made an excellent start to 2023 with a strong Q1 performance, demonstrating continued business momentum. Duncan, back to you.

Duncan Tait

Group CEO

Thank you, Adrian. Inchcape is a business with great momentum and an exciting future. With a clear and proven strategy, we are well positioned to capitalise on further opportunities for organic growth and market consolidation and I am confident we'll continue to deliver sustainable growth and long-term value for all our stakeholders. Adrian and I are now ready to take your questions.

Q&A Session

Andrew Nussey - Peel Hunt

Two questions from me please, really aimed more at the medium-term outlook. I guess first of all, in terms of the Americas and specifically Chile and Colombia where obviously you referenced weaker market volumes in the first quarter, really just looking, Duncan, for perhaps a little bit more comfort around your medium-term thoughts on those markets and if they have changed at all, given the current market dynamics.

Then secondly, in terms of distribution excellence, as you're beginning to see improved vehicle supply, maybe some better insight on order book dynamics, where there's your confidence again in that medium-term objective of high-single-digit organic profit growth over the medium term, please.

Duncan Tait

Good morning, Andrew. Okay, thank you for those two questions. Adrian will take the first one and I'll come back in for a view on our order book for the medium term.

Adrian Lewis

Thank you, Andrew, so on your question around the attractiveness of the markets that we are increasingly exposed to with the acquisition of Derco. The Latin America business across Chile, Colombia, Peru, Bolivia, Costa Rica, Panama, they are all very strategically attractive. They all have the characteristics of GDP growth, low motorisation rates, which means the opportunity to grow the number of vehicles in the market over time is very attractive.

Whilst we like the vehicle business, don't forget we also sell parts and servicing facilities and we have a VLS, vehicle lifecycle services strategy which will increase our exposure to the used car business. So all of those streams of business remain attractive to us. So I don't think we've seen anything that changes our investment thesis behind Derco from a market perspective, they remain very attractive over time.

If you take Chile as an example, it's a 400,000 car market roughly speaking. If you look at the local automotive intelligence agency, ANAC, they talk to a 500,000 vehicle market towards the end of the decade and that's replicated across LATAM as well when you go through the other markets.

Of course, it's not going to be a straight line and you mentioned some of the short-term market dynamics, particularly in Chile and Colombia. Chile was 17% down in Q1, you've got to remember we are lapping a really strong Q1 in 2022, fiscal stimulus in Chile and also a bit of a post-COVID tailwind giving the market a very strong comparator.

The external market - and we agree with them - looks to see the full year Chile market somewhere towards minus 10, so minus 17 will be the low point and we expect a stronger growth rate as we go through the course of the year.

Duncan Tait

A couple of things, it's just worth standing back for a moment and think about what we committed at the Capital Markets Day, which we stand by. So mid-high single-digit profit CAGR in our distribution business, plus M&A, plus VLS at £50 million around an incremental profit contribution towards the end of the planning period. I think our Q1 results in terms of revenue growth reinforce some of that proposition that we've made and the way to think of the growth of our business.

Also in terms of M&A, since the Capital Markets Day let's not forget we completed on the Morrico deal in Guam, our Simpson's business in the Caribbean, Ditec in Chile and Derco, with two more acquisitions announced in the first quarter and more contract wins. It's not just Tata, but it's BYD, it's Great Wall, ORA, it's Geely and others.

Now in terms of your specific question, Andrew then, in terms of how we're seeing order banks and market performance, it's worth going through the regions one by one to give you a little bit more colour. For the Americas, 10 of our 12 markets we're seeing high single-digit, low double-digit order intake. Those markets continue to perform really well for us and we're seeing some supply come back from brands that were supply constrained over the last year or so.

As Adrian said, in Chile we are seeing better news in the second half, according to our intelligence on the ground. Africa is steady as she goes, no concerns about that Africa business. Then into Europe and I don't think this should be a big surprise for us, is that we are seeing lower levels of order intake in Europe.

So what I would say is the order bank in Europe from hitting an all-time high in the second half of 2022, is down a little bit, as of now it's down about 10%. So it's the slow unwinding of the order bank and we see that order bank taking us through the vast majority of 2023 and we are actually, as we review the Europe business, we're already taking orders into 2024 in the business now.

Then in APAC, let's split it into three. The Asia developing markets, Guam, Brunei, Thailand, Indonesia, we've just announced the entry into the Philippines, those businesses remain pretty hot for us. Good order intake, good growth year-over-year and frankly if we had more vehicles, we'd be even happier.

Hong Kong and Singapore showing signs of recovery. I wouldn't put anything in a model for this year but think 2024. Finally, in terms of Australasia, we're seeing strong demand, good order intake, good growth in that business and our supply is coming back a little stronger than we expected. So by and large, Andrew, if I think about our medium-term guidance, we remain committed to that and if you look at how the business is performing in the near-term, I think that's supportive of what we've committed to. I hope that gives you a little bit more colour.

Andrew Nussey - Peel Hunt

That's great, thanks very much, Duncan.

Arthur Truslove - Citi

Thanks very much, three from me if I may. First question was just on the aftermarket in Chile and obviously Derco in particular. There's obviously been a number of strong years for new car sales in Chile, should we think of this as being a positive driver for aftermarket performance over time? If you could comment on how that was in the first quarter for Derco. Then within that also is it reasonable to think that the aftermarket proportion at Derco is comparable with the rest of the Group?

Second question, I think, Adrian, if I understood you correctly, you said that you're reducing orders into Derco as a result of having taken on higher inventory. Just wonder if you could provide a bit more detail on how that process works and how it's going.

Then also on Derco, really good to see that you've reiterated your guide for this year and next. I just wondered if you could give us an idea from a new car volume or revenue perspective, whatever you think's most meaningful, of the sort of level that would become challenging for the guidance that you've issued for this year, thank you.

Duncan Tait

Thank you very much, Arthur, I think those questions are all heading Adrian's way and I'll add a little bit of value towards the end. So Adrian, over to you please.

Adrian Lewis

Yes, hi, Arthur. Thank you, three good questions. Let me tackle the aftermarket one first. I think it's probably fair to say that the Derco business has a good exposure to the aftermarket business, probably a greater degree than we would see in the normal - in our core business. There's a number of business units within the Derco acquisition that are slightly different or expand our exposure to the broader aftermarket business with parts particularly. So we're very excited about that.

The broader Chilean market, I don't think my answer to one of the questions was heard earlier. The Chilean market is going to grow from around 400,000 new cars to around 500,000 new cars if you take the external market forecast for that region. With that, the car parc within the market will grow and with that will bring a tailwind for aftersales and our broader VLS business as well. So we're very excited about that. Proportionately, I think you could think about aftersales being slightly stronger in Derco than the broader business.

Your question around inventory and orders and reducing orders with our OEMs and how that process works, as I said in our statements, we have prioritised the alignment of our practices around sales and operational planning as one of the first things we've done as part of the integration.

I'm super pleased with, firstly, both the mindset and change that the team have been through, but also the reaction and response to our OEMs. One of the things we pride ourselves on is the way we use data to inform our decision-making. When you work with the OEMs with a data-based conversation, it becomes a very positive and constructive conversation, so we're really happy with that.

What we also said at the full year results is that we would work through the £200 million of inventory that would be higher than an anticipated or expected level of working capital across 2023 and we've reiterated that today. We are not taking short-term decisions that distort the market in order to solve that challenge. We're working across 2023 and we're confident of the progress we're making and you'll see more as we publish our more detailed numbers in July.

In terms of Derco and new volumes, I think the first thing to say is it's a four market business but with Chile and Colombia being down as we had expected them to be, but with growth in Peru and Bolivia. Chile in and of itself is down about 17% in the first quarter. You've got to remember that we are lapping some pretty strong comps in the first quarter of 2022, fiscal stimulus, post-COVID bounce, all created quite a tough comparator.

The external market commentary, I was talking about minus-10 for Chile, so we expect a better performance from a year-on-year perspective and in absolute terms in the second half, as we go through the year and into the second half. I don't think, if you stand back, any of the short-term market changes that we've seen or the market position that we've seen changes our investment thesis around Derco. We're still very excited about the GDP opportunity and the low motorisation rates and the growth over time that all four markets offer for us. So we're super happy with performance to date and the midterm prospects as well.

Duncan Tait

Arthur, was that useful?

Arthur Truslove - Citi

Yes, thank you very much. That was perfect, yes, thank you.

Georgios Pilakoutas - Numis

Thanks, morning, team. Maybe just one more on the Americas demand. I guess really just the point that the monthly data's been very volatile, so just wondering if there was anything that you think is particularly driving that. When we look at the last quarter in Chile, January was down 20% versus 2019, March was plus 20%. What is a truer sense for what the underlying demand is? Is it more in the middle, or somewhere towards the lower end, the upper end? So anything you can share there.

Then secondly, on the Derco inventory, we're just wondering if you could talk a little bit more around what that inventory is. Is it new, used, are there any particular brands? Just to give a bit more of a sense of how you're going to manage through that.

The third one is on M&A and just how you think around the Group's balance sheet position versus doing further M&A. It didn't stop you in the first quarter, but there must be a point where you feel like you need to prove things, so if that is the case what needs to be proved? Is it getting towards the end of this year, where leverage is back into a more comfortable position? Or would you see any kind of restrictions to M&A?

Can I just confirm some comments at the beginning, Duncan, that you said that the Derco consideration had been paid? Hopefully that's a very quick one.

Duncan Tait

Yes. Georgios, can you just give me question 4 again please? I just want to make sure we got that clearly.

Georgios Pilakoutas - Numis

That one was just around the Derco consideration being paid.

Duncan Tait

Okay, fine. I'll cover how we're seeing demand specifically in Chile and I'll hand inventory and M&A relative to balance sheet and question 4 to Adrian. Q1 Chile dropped, the market dropped 17% year-over-year. That was slightly better than we expected, because we were thinking more of a 20% drop in the first quarter, so slightly better.

Commercial vehicles showed more resilience than passenger vehicles and of course, you have exposure to machinery, construction, commercial vehicles and to passenger vehicles in that Chile market. We did see supply coming back from some of the OEMs, such as the Japanese OEMs that had struggled more in previous quarters.

Now in terms of how to think of that Chile market for the rest of the year, from the local intelligence we have from the agency on the ground, the motoring agency on the ground, is that Q1 is most likely to be the trough of the year, Georgios. The indication overall is one is year-over-year for the drop to be more like 10% and for the second half to start to get back to growth.

Now it's a bit early for us to forecast according to that, but that is the information that we're getting from our team on the ground, but also from the independent motoring organisation called ANAC in Chile. So that's the overall picture we are seeing so far. As ever in this world, unlikely to be in a straight line, but the second half looks way more positive than Q1 and we think Q1 is the trough. Adrian, over to you for question 2, 3 and 4.

Adrian Lewis

Sure, if I cover Derco inventory in the first instance, I think your question was give me a sense of brands and new versus used or parts. It won't be a surprise for me to say that the inventory is largely a new vehicle inventory base.

It's not just a Chile-based inventory, of course, we have good size businesses in all markets. When you go back and think about where the inventory came from, we saw strong supply in 2022, particularly from the Chinese brands and we saw recovering supply from some of the other brands that Derco represents.

So what's been really encouraging for us is that when we've gone back to all of the OEMs across the course of the first quarter of this year and worked with them using our data and the tools that we have and our predictions around demand, to temper that supply across the next six to nine months there's been an incredibly supportive response.

So we're very confident that we're going to make progress. We said that we would not take short-term actions to correct, because that creates market distortion, that's what we're doing and we stand by the £200 million working capital inflow that will arise as we normalise the working capital cycle in Derco by the end of the year.

Your second question was M&A, balance sheet, what do we need to see before we carry on. Firstly stand back, this group is a highly cash generative group, we will continue to be highly cash generative and we have a very, very active and full M&A pipeline. The two acquisitions that we have announced this year, in the first quarter of this year, in the Philippines and in Indonesia, reflects that pipeline, it reflects our deepening relationships with our OEM partners and the opportunity that presents itself.

We also said, particularly with the Indonesia deal, that we expect to conclude the year broadly with a leverage position that is consistent with where we started the year, at around 0.6x, with the underlying free cash flow generation supporting the balance payments to the Del Rio family and also the acquisitions that we have announced today and we stand by that today.

So 0.6x is in a really strong position. We have a full M&A pipeline, particularly in the bolt-on space, so we're continuing to pursue that. We have a capital allocation policy that caps us out at one times EBITDA and we're not moving against that at this stage. So we've still got headroom to go as that pipeline comes through.

Then the final point, which I sort of touched on, the Derco consideration, what we said was that was going to be paid mostly across half one and a little bit across the second half. So we are on track with that.

Duncan Tait

Thanks, Adrian. Georgios, let's not forget it's not just about M&A in terms of how we grow this business. There are also contract wins, of which the Tata Motors is a good example and the APAC team have not just been working on building the M&A pipeline, but also on contract wins. So Georgios, how did we get on answering your questions?

Georgios Pilakoutas - Numis

That's great, thanks so much, guys.

Akshat Kacker - JP Morgan

Morning, Duncan and Adrian, Akshat from JP Morgan. Just one clarification please, on the Americas business in Q1 could you just give us more detail in terms of the overall volume and revenue development in the region organically please? That's the question please, thank you.

Adrian Lewis

I'll take that one. Our Americas business, as you say, has a mix of volume and price. We are exposed to Chile particularly, so the volume position followed that, followed particularly that market. I think you should also think about a stronger and growing aftersales business and increasing exposure to a strong used car business. But also what we've seen during the course of the first quarter of this year is there's been a skew towards higher average selling prices.

So across our Americas business our revenue performance outperformed the volume picture that we see across the picture. As I said in my comments earlier, we've seen share gains in some brands where we're lapping supply constraints and we've seen some normalisation of share where brands were doing really, really well in prior periods. So it's been a mixture with the revenue overall outperforming the volume picture.

Akshat Kacker - JP Morgan

The other thing in terms of quantification, is it possible to talk about revenue development in the region?

Adrian Lewis

We don't disclose volume by regions. We'll give you more detail around our segment performance at the half, but we don't disclose volumes by region.

James Zaremba - Barclays

Hi, good morning, I had a similar question in terms of mix of price and volume, but I guess at the Group level. There's been quite a lot of noise in the industry about price cuts in some markets. Is the expectation for the full year still for average selling prices to be up?

I think at the results you mentioned you thought the market was maybe 10% below your normal levels. We've got mid-single-digit volumes this year, so I guess you've got another year of recovery in 2024, is that the right way to think about the medium term? Thank you.

Adrian Lewis

Perhaps I'll take the short-term points and Duncan may want to talk about mid-term. I think the mid-single-digit volume growth is still how we see the overall market supply has been recovering and is broadly where we thought it was going to be. It is improving and if you look across the industry, we are seeing an uptick in vehicle availability, which is good. Certainly, our performance in quarter one reflected that across the Group.

What we also saw in Q1, and you've seen the organic growth of 15% in the core business, was the follow-on effect of inflation from the second half of last year, where we've seen prices higher that we saw in the first quarter of last year. So our 15% is a combination of that mid-single digit volume and price high.

As we go through the year and as you saw in the second half of last year, a much stronger top line than in the first half, because of some of those inflationary factors and acquisitions we do expect that growth rate to normalise back towards the volume-led number with a small price tailwind.

So I think our guidance at the year end, or not a month ago, that's how we still see the full year. Pleased with Q1 a bit of price tailwind helping as a result of the second half last year inflation. But Duncan, do you want to perhaps comment on mid-term?

Duncan Tait

Sure, thank you, Adrian. In terms of 2024, let's talk about supply first. I think as an industry, supply I think will continue to normalise during 2024. The jury is still out as to whether that's a normalisation in first or second half, but it now looks much more like a 2024 normalisation of supply.

I would point out a few things about the Inchcape markets. Most of our markets remain below the 2019 levels. I would also say that the age of the car parc in many of our markets has aged quite significantly over the last few years and you know we think there's been about a 30 million vehicle gap generated by lack of supply over the last three, four or so years, which I think are positive for the Group overall.

Then a few more detailed comments about us. Let's not forget Hong Kong and Singapore are way, way off a reasonable peak, not even a peak-peak that you would have seen for those two markets. We are seeing green shoots of recovery in Hong Kong, in fact we're building an order bank in Hong Kong and the Great Wall's ORA brand, we've pretty much sold out our business plan for the whole year but have not yet taken delivery of vehicles. In Singapore we can see that COE cycle start to tip upwards from 2024 onwards.

Then we continue to have an order bank in Europe, we have an order bank in Australasia. Our Americas markets, I think, will continue to give order growth into 2024 and we should see at that point more of a normalisation in terms of that growth of our business in Chile and also in Colombia.

So in summary, supply coming back to some type of normalisation. Our markets are way behind. Our order bank - sorry, the car parc is aged and we have some markets that are tailwind to the Group as we get into 2024. James, I hope that's helpful.

James Zaremba - Barclays

That was very helpful. Just one clarification from Adrian maybe, would I be right in reading that prices have still increased marginally year-on-year versus the level in the second half? I guess there's a big annualisation effect but there's also been an actual net increase as well.

Adrian Lewis

I think what you're seeing in Q1 is the consequences of the second half price movements. A second round of inflation to come, we'll only really start to see that as we start to get through the balance of the year. I think it's probably getting less pressure on input prices from our OEM partners as we go into new model years. So we don't expect to see the same levels of price inflation that we saw in 2022.

Duncan Tait

James, thanks very much indeed. Thank you very much, everybody, for your questions and for joining us on the call this morning. I hope you share our excitement about Inchcape's continued strategic progress and the growth opportunity we are intent on capturing. Look forward to updating you further at our interims on 27th July and in the meantime, please get in touch with Raghav if you'd like to follow up on anything. Thank you.

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