Inchcape PLC

Q3 23 Trading Update | Audio Webcast

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Transcript

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Duncan Tait: Good morning, everyone, and thank you for joining us. I'm joined on the call by our CFO, Adrian Lewis, and our Head of Investor Relations Rob Gurner. I'll begin by giving an overview of the group's performance and outlook before handing over to Adrian who will give more details. We'll then take your questions. Inchcape's strong performance in Q3 was another demonstration of the resilience and diversified nature of our business. We delivered revenue growth of 35%, including 10% organic growth. Our distribution business delivered organic growth of 13%. This was supported by continued momentum from APAC with broad-based growth across our markets. Our performance in Europe was strong, driven by the continued unwind of our order bank, though new consumer demand across Europe remains muted. In the Americas, there was growth in the majority of our markets in the region, and we are delivering market share gains and accelerating our cost synergy program this year to offset softer markets in Chile and Columbia.

On Derco, we are delighted with the progress made on integration. I want to reiterate that Derco is a superb business. It gives us further scale and diversification in the Americas and brings us new longstanding OEM relationships. Furthermore, we are supporting some of those OEMs in markets outside the Americas, as evidenced by our global strategic agreement with Great Wall, with whom we are already establishing a market presence in Indonesia. On that point, we made excellent strategic progress across the group during the period. We won five new distribution contracts with leading Chinese OEM, Changan, in the Philippines, and across four African markets. This partnership was developed primarily as a result of Derco's longstanding relationship with Changan. These wins take us to 16 contract wins and acquisitions so far this year compared to just 5 in the whole of last year. This is further evidence that we are building a global market leading distribution platform from which to support our OEM partners.

Importantly, we continue to build a strong pipeline of future potential contracts to help support organic growth. Our diversified market footprint, strong OEM relationships, and our robust financial position ensure the Inchcape will remain the natural consolidator in a fragmented industry. To that end, we completed all three previously announced acquisitions in APAC, in the Philippines, Indonesia, and New Zealand. We are also continuing to invest in our market leading digital and data capabilities to support the performance of our distribution business. Our digital and data capabilities are helping us to drive the development of our Vehicle Lifecycle Services initiatives. In this area, we continue to be agile in adjusting and optimising our capacity in bravoauto as we develop a number of business models in various markets.

The development of our Digital Parts Platform in Australia is going extremely well and we continue to plan a rollout of the platform in other markets in APAC next year. We'll continue to provide a further update on VLS at our full year results in March. Moving to Outlook, based on prevailing market conditions and considering accelerated cost synergies and the contribution from acquisitions, expectations for full year 2023 results remain unchanged. These expectations were originally outlined at our interim results in July. I'll now hand over to Adrian to take you through the details of our performance during the period.

Adrian Lewis: Thank you, Duncan, and good morning everyone. In Q3, the group generated £2.8 billion of revenue, up 35% on a reported basis and up 37% and constant currency. On an organic basis, revenue grew by 10%. Distribution revenue increased by 47%. The M&A impact largely reflects the consolidation of Derco, and on organic basis, Distribution revenue increased 13%. Let me give you now more colour on each of the distribution regions. In the Americas, we delivered a resilient performance with growth in the majority of our markets, market share gains and accelerated cost synergies offsetting softer markets in Chile and Columbia. We are especially pleased with our share performance in the softer Chile market, where share has been running well ahead of the prior year and ahead of half one run rates. In APAC. There was continued momentum with broad-based growth across our markets, including Hong Kong and Singapore, and there was further positive momentum in Australia where our market share with Subaru continues to improve.

Our APAC region was further supported by the completion of the three acquisitions during the quarter. In Europe, there was good growth in key markets driven by the continued unwind of our order bank. New consumer demand in Europe remains muted. The group's performance in Africa was solid and will be further supported by our contract wins in East Africa with Changan. On Derco, as mentioned earlier, we have proactively accelerated our cost synergy program and we now expect to deliver an in-year benefit of up to £20 million from our previous expectations of an in-year benefit of around £13 million this year. We remain on track to deliver the full £40 million of annualised cost synergies in 2024. We continue to expect Derco to deliver operating margins at the top end of the 5% to 7% range typical of a distribution business this year and that is before synergies, of course.

In the context of a more challenging operating environment in the likes of Chile and Columbia, I'm particularly pleased with the progress we are making in improving Derco's working capital position. We have now reduced Derco's excess inventory that was £200 million at the start of the year by 50%, an improvement from the July position where we had got through 20%. This is great progress given the market circumstances.

Our continued focus on aligning inventory management practices to those employed across Inchcape is working well, and importantly, given the market conditions, we have continued to work proactively with our OEM partners to revise down previously agreed orders for new vehicles as we move towards 2024. As a result of our progress in this area and with further alignment of trading terms, we continue to see a working capital opportunity at Derco to be delivered by the end of 2023. Also, as we said earlier this year, this will be partially offset by a working capital outflow across the rest of the group as we started from a highly optimised position.

Overall, we are pleased with the progress we've made with the integration of Derco and the operational performance of the business to date. Moving to Retail, where reported revenue was robust with an increase of c.2%, volume growth was mainly in the fleet sector offsetting the change in revenue recognition relating to the agency model. Excluding this, revenue growth would've been around 12%. This robust performance reflects the strength of our retail business amid a challenging consumer sentiment environment. Overall, the group delivered another strong performance in Q3 highlighting the continued resilience and diversification of our business. That's it from me. Duncan, back to you to sum up.

Duncan Tait: Thank you, Adrian. Inchcape produced another strong performance in the third quarter with double-digit organic growth and I'm pleased with our ongoing momentum. Given our continued strategic progress, I remain highly confident about the medium to long-term future of the group. Adrian and I are now ready to take your questions.

Operator: Thank you very much, sir. Ladies and gentlemen, as a reminder, if you want to ask a question, please press star one. Please also ensure your mute functions not activated, to allow your signal to reach the equipment. Our very first question is coming from Mr. Andrew Nussey calling for Peel Hunt. Please go ahead, sir.

Andrew Nussey: Yep, good morning. A couple of questions from me. First of all, when we look at Chile and Columbia, please, can you just update us on the relative scale of those markets in the context of Distribution and what industry are suggesting for market performance in '23, and any thoughts on what the market estimators are saying in terms of '24? Secondly, Duncan, if you could just update us around the pipeline, which you alluded to in terms of new Distribution contracts and the potential for M&A, please.

Duncan Tait: Very good. Thanks very much, Andrew. Good morning. Look, let me comment on Chile and Columbia to start with. You remember, the largest market of the two, clearly, is Chile by some way. The original forecast for that from the local motoring organisation, ANAC, was 380,000 units for 2023. They've moderated that during the year.

At the interims, around 360,000 was their forecast. They're now saying about 310,000. We based our judgment for the year on a 20% decline. We've been clear about that since we mentioned the acquisition over a year ago. And this year, yes, it's around 310,000, so about a 30% decline. Colombia is also seeing a decline of similar levels in terms of 30% year over year. So one of the reasons why I'm pleased with our America's performance, despite declines in those two markets, the America's business continues to deliver for us.

Now as you look into 2024, we said at the interims, we didn't envisage Colombia improving in 2024, and we are taking a sensible and prudent view of how Chile will perform into 2024 also. So we're not expecting a big uptick by any means from Chile into 2024, and we will plan our business accordingly.

Look, in terms of the pipeline, you can see this year, we've had a stunning year already, 16 deals, 13 contract wins, three pieces of M&A, which have now completed. And look, the pipeline for both contract wins, and M&A remains strong. I would remind you that the contract wins we're having aren't just with Chinese OEMs, although clearly in Asia PAC and in Americas, there are, but we're also winning with Subaru and Mercedes at the same time. And also, we've added more Stellantis markets, JLR at the same time. So, the pipeline remains strong, but we at the same time remain very disciplined with valuations of M&A and making sure that we're adding these contract wins into markets where we have scale like Changan into the Philippines and Great Wall Motors into Indonesia. So, Andrew, hopefully that helps.

Andrew Nussey: That's great. Thank you.

Operator: Thank you very much. Our next question is going to be coming from Carl Smith of Zeus. Please go ahead.

Carl Smith: Hi. Good morning. Just two questions from me. First of all, it's good to hear about the recovery in Singapore and Hong Kong. Would you say that those markets are back to normal, or have you got a bit more recovery to come from those in 2024? And then the second question was on the impact of the agency sales model. I understand what you're saying about if you exclude that impact, you'd have a 12% organic growth. Have we seen the full impact of that on retail revenues or would we expect more in 2024 as well?

Duncan Tait: Okay. Thanks very much, Carl. I'll take one on Singapore and Hong Kong, and, Adrian, if you could follow up on agency. So look, we took the Board of Directors of Inchcape to Hong Kong and in fact the Philippines just a few weeks ago. And Adrian and I have also been in Singapore, so we got first-hand knowledge on the ground as to what's going on in both markets.

Singapore has been muted for some time. We're at the trough in Q3 in terms of COE availability. We're seeing improved availability in the fourth quarter, and the forecasts show an improving Singapore into 2024 so further COE availability. Now, it won't get back to its peak in 2024, but we can now see people surrendering their COEs and COEs coming back into the market. So we are relatively optimistic about Singapore into 2024.

And Hong Kong, as a result of our broader EV coverage with Great Wall and with SAIC's MIFA product and with Toyota bringing more products to market for us, we feel optimistic also about 2024 for Hong Kong. And we'll see improvements in Q4 as we built a really big order bank for those cross-border people carriers that we see. So optimistic about both markets, but they're not going to get back to their peak in 2024 but they are improving. Adrian, over to you.

Adrian Lewis: Yeah. Thanks for the question, Carl. So, if I step back a little bit, at the start of this year, our relationship and the retail model for one of our brands in the UK market changed. It changed to what's called the agency model, and that is essentially where we take a commission on the delivery and the sale of a new vehicle, which means it's just a bit of an accounting adjustment to revenue recognition, which is why we think it's helpful to give you an indicator of the performance without that. It gives you an indicator of the volume performance and the price mix that is attached to that.

So yes, for that particular brand, you have seen the full impact of it. We do expect other brands to start to shift towards that sort of model, but probably not until the end of 2024. And we'll update you as to how to think about revenue and operating margins in the retail sector attached to this. I'll remind you that what we've said and what we're actually seeing in practice is that at a profit perspective, it's broadly neutral. So, whilst we don't get the top line, we do get the commission, which is consistent with the gross profit per unit that we would've seen prior to the agency model coming in to play.

And I would just add, at the same time, we have a much lower stock holding as a result of that. And a final thing on this, this is retail only, which is obviously the UK predominantly. In a distribution market, which is where the majority of our business is that this is not an issue and the operating model is entirely down to us in partnership with our OEMs to decide how we approach and put together our route to market.

Duncan Tait: Thank you, Carl. Hopefully that was helpful. Thank you.

Carl Smith: Yeah, yeah, thank you.

Operator: Thank you so much, sir. We'll now move to Georgios Pilakoutas of Numis. Please go ahead.

Georgios Pilakoutas: Thanks. Morning, team. Changan contract wins. I just wanted to clarify, are these new markets for Changan? And if you give us any sense of what kind of scale they could be, if they are new markets and maybe short to medium term plans of where Changan's aspirations are in terms of market share within markets.

Then one on FX. If you could just update us on the translational headwind for next year and then perhaps even touch on how given we're seeing some depreciation in some of the America's markets, just a bit of an update on how the transactional impact, if at all, is working there and how Derco is dealing with some depreciation in those markets.

And then last one is just given ongoing rise in interest rates and to some extent where equity markets in your share prices, just if that changes at all your shorter-term ambitions around M&A versus leverage reduction versus even buybacks.

Duncan Tait: Very good. Thank you, George. I'm sure that was three questions.

So, look, let me comment on Changan and then I'll ask Adrian to give you some thoughts about how you might scale it, then FX and rates is coming your way, Mr. Lewis. So look, I think if I take a step back, Changan is further evidence of the impact that Derco is having on Inchcape. Derco had had long-term relationships with Changan. I was in China meeting key Chinese OEM partners in the middle of June, of which Changan was one of them. Shortly after, we announced a global partnership with Great Wall Motors, but we were also talking to Changan about markets at the same time.

Now, I didn't quite expect the Changan deals to happen quite as quickly, but clearly, they have. The four markets in East Africa are new, leveraging our cluster approach that we have in East Africa. In the Philippines, they have been working with another distributor prior to Inchcape but have now switched that distribution contract to Inchcape. Look, that's a big market. That's 110 million people with really good GDP growth, low motorisation rates. It's a great market for us. And George, we're going to run that through the same infrastructure of the CATS business that we've just completed in the Philippines during the third quarter. So, in the Philippines, don't forget, just a few weeks ago, we had our digital delivery centre with about 700 people in it but no distribution business. A few weeks later, we have the

CATS acquisition and now Changan going through the same infrastructure. So, look, I think more to come in terms of contract wins, both with our traditional OEMs and our Chinese partners, but nice progress in Q3.

Adrian Lewis: Thank you, Duncan. I think I'll break your question into a few parts in relation to FX and rates.

In terms of Changan, I think, as Duncan has said, it's a super exciting opportunity and the opportunity for us to scale those businesses over time, but you shouldn't think about this as being a big call on capital. As we step into those markets, we'll be leveraging third-party networks and, as Duncan has said, leveraging our back-office infrastructure.

Moving to your point around FX, look, it's a bit early to call FX headwinds and tailwinds on a translational basis for 2024. But I would say that for 2023, it's broadly neutral for us. In terms of your question around transactional FX movements and just to give you a bit of context here. And I'll speak specifically just to give you an example about how we've approached this with Derco. We have currency pairs of Chilean Peso and the COP in Columbia, with USD, Japanese Yen and Renminbi.

In all of those currencies, one of the first things we did as part of our integration planning was to step into some hedging arrangements to make sure we protect against short-term FX volatility. That is our hedging approach. It's one that we have adopted across Inchcape for a number of years.

What it does, it enables us to create time against FX movements that don't leave us either overly advantaged or disadvantaged in the market from a retail pricing perspective. And now of course, as FX moves, ultimately that has to translate into our commercial operating model, but our hedging policy gives us time to do that. And the movements you've seen in those pairs that I mentioned has been translated and you've seen today us underwriting and reiterating our operating margin expectations for the Derco business, and that hedging policy has helped us to do that.

Your final question was around M&A leverage and buyback. I think our position, George, is exactly as it has been. Our capital allocation policy still stands. Our first priority is to invest in this business, and we have done that this year. Our second priority is our dividend payout ratio, which we are committed to. And our third priority is to invest in M&A. You've seen us do that in the third quarter of this year. We announced three deals in the first half and we've completed them in the third quarter.

And if after all of the end of that there's cash left over for buybacks, then that's how we would deploy that capital. But right now, our pipeline is full.

We think there's a really exciting M&A opportunity to consolidate this business as there is by growing the business through contract wins. Our capital allocation policy remains unchanged. Hopefully that covered all your questions.

Duncan Tait: Thanks, George.

Operator: Thank you very much sir. We'll now move to Arthur Truslove of Citibank. Please go ahead. Your line is open.

Arthur Truslove: Thanks very much and good morning. First question from me, just to clarify a couple of points from guidance from earlier in the year related to Derco's. In particular, are you still expecting to get rid of all of the £200 million of excess inventory this year? And previously you talked about Derco being 15% EPS accretive this year. Just wanted to confirm that both of those two pieces of guidance are still in play.

And then secondly, on the synergies, you're obviously expecting to deliver £20 million this year. Obviously that must mathematically have accelerated materially in Q3. Just to clarify from your statement, does that mean that you are now expecting to do £40 million next year? That being £20 million in the bridge.

And then the final question I had on the new acquisitions, obviously you've talked about them being around £400 million of revenue. In terms of PBT contribution in Q4 and then on a full year basis, are you able to just shed some light on that? Thank you.

Duncan Tait: Very good. Thank you, Arthur. They'll all three questions are going to Adrian.

Adrian Lewis: Thank you, Duncan, and thank you, Arthur. First one around Derco, and there's a couple of pieces in there. The inventory balance that we acquired as we had said at the start of the year, was £200 million higher than we had originally anticipated. Now you'll also see in the statement that we've released today, Arthur, that we have made great progress in that. And so we're really pleased, particularly in the context of the marketplace, to be around half of the way through that inventory reduction plan.

We set out at the start of the year, we said we were going to work with our OEM partners. We were going to act responsibly in the marketplace to make sure we deliver across all of our stakeholders in moderating down that inventory balance. And that's exactly what we've done. That's a daily, weekly, and monthly conversation with our OEM partners. And as the market landscape has changed, particularly in Chile and in Columbia, we've been working with them to moderate that down.

We are on track with that program. We are acting responsibly and we are going to get to where we thought we were going to get to. But I think the other opportunity, which we note in the release, is around overall working capital. The alignment of our trading terms with Derco has been also a success for us, which will give us further working capital opportunity. And I'll remind you there are some offsets against that with the core groups starting from a highly optimised position.

Around the 15% EPS accretion, I think what you can see in the statement is a reiteration of the Derco acquisition being on track, the integration program being on track. You can see us accelerating synergies and responding to a market situation and reconfirming our profit expectations for the year, which is consistent with more than 15% EPS accretion. We see the overall Derco acquisition as being firmly on track and stand behind those EPS commitments that we made at the start of the year.

Synergy benefits £20 million this year. Yes. What we have done practically and in the market is we've been working really hard to make sure we've got the right cost base for the markets that we are presented with in Chile and in Colombia, particularly as we bring those businesses together. And we've brought forward some of those activities.

The benefit that you are seeing in this year's P&L as a result of those synergies is around £20 million. And you're absolutely right. We are standing also behind the overall program of activities adding up to £40 million of cost synergies. You are right. Next year's contribution to profit will be £20 million above what you've seen this year so £40 million in aggregate.

In terms of the new acquisitions, PBT contribution in Q4, we are not giving specific guidance around those, but you should think about those as being low single digits. The APAC region is one that features a number of very mature markets, which tend to have higher than average operating margins.

Whilst it's not going to be accretive to APAC, those businesses will certainly be in line with core distribution average margins.

And we will cover the full year guidance for those acquisitions as part of our 2024 guidance in our results announcements in March. Hopefully that covers your questions, Arthur.

Arthur Truslove: Thank you very much.

Duncan Tait: Thanks, Arthur.

Operator: We'll now move to James Zaremba of Barclays. Please go ahead. Your line is open, sir.

James Zaremba: Good morning. I just had a quick question around the comments around muted European demand. You've clearly managed the Derco margin really well with what would probably be called muted demand in Chile and Columbia. Are there any differences in how you'd manage that European distribution business for lower volumes, or is it the same playbook? And then secondly, on muted demand, is that more volume or mix or a combination of the two? Thank you.

Duncan Tait: Thanks, James. Look, just on the Americas, yes, of course we focus very much on Chile and Columbia, but don't forget we have 12 American markets. We've since opened Mercedes and Honduras, by the way, 10 of the 12 markets still remaining in growth for us in Americas.

Now in Europe, what we've said this year is we are unwinding a big order bank we've built up in Europe over the past trading periods. That was winding down in the first half, and we've seen really good supply gain from our European partners into those Europe markets in Q3.

Now, at the same time, what we said at the interims, and we are reiterating today, is that though we're delivering great near term revenue performance and of course profit performance in that European market. European consumers are somewhat muted, and we're seeing lower levels of order intake exactly as we said at the interims. That order bank is coming down and therefore, we expect that to have an impact as you move into 2024.

Now, in terms of mix, our partners are being able to get us better mix as we think as we go into 2024, several product launches coming out from our OEM partners, including our major partner in Europe. The mix may well improve, but I don't think we should duck the punch that European consumers remain somewhat subdued in their buying habits. I don't think, by the way, we're any different from any other OEM or distribution company in Europe in that regard. Adrian, did you want to add anything?

Adrian Lewis: Yeah. From a margin perspective, what you saw in the first half was a very, very strong operating margin from Europe, and that came largely because of a very high level of operating scale that we were able to put through those businesses. As supply eased, then we were able to deliver both against new demand and also the pent-up demand from the order bank that carried forward. So you saw very high scale, giving us very high operating margins. As you go forward, we should expect to see those normalise and moderate. And I think what we said at the half year was that the half year for Europe and Africa should not be the roll forward assumption as we move into 2024.

James Zaremba: Very clear. Thank you.

Duncan Tait: Thank you, James.

Operator: Thank you very much, sir. As we do not appear to have any further audio questions at this time, I'm going to turn the call over to Mr. Rob Gurner, who will handle the questions submitted by the web. Thank you.

Rob Gurner: Thank you, George. Good morning, everyone. Just one question from Akshat Kacker from JPM. For Europe, can you talk about operating leverage in the context of low volumes next year?

Adrian Lewis: I think, Rob, that's consistent with the comments I just made. This year, we've benefited from additional supply coming off of a restricted supply performance in 2022. That's the seen us drive. You saw the high organic growth rates we were publishing in the first half. We're continuing to see a good trend of supply into the third and fourth quarter. However, we should note the underlying consumer demand, consistent with Duncan's comments earlier, is down. And so you should expect to see a bit of de-leveraging from a scale perspective as we move into 2024 for Europe.

Rob Gurner: Thanks, Adrian. I've just seen there's one more question coming from the call. George, do you want to ask Paul to ask his question?

Operator: Most certainly, sir.

Rob Gurner: Thank you.

Operator: Yes, will do, sir. Okay, we have that last question that just came in. It's from Paul Rossington of HSBC. Please go ahead, sir.

Paul Rossington: Good morning. Hopefully, you can hear me. Quick question on Singapore. The recovery in Singapore in COE supply is good to see. Is there any reason why we wouldn't see the COE cycle perform as it has done historically or would you not expect it to peak at the same levels over the medium term as we might've seen historically? Just trying to get a feel of what the trough to peak movement in the COE cycle could look like. I think it's smoothed a bit, but I'm just wondering what your take is on that Singapore COE cycle over the medium term.

Duncan Tait: Very good. Paul, I'm going to hand this to Adrian because, actually, he was our APAC CFO for a period of time and was based in Singapore and was there just a few weeks ago.

Adrian Lewis: Yeah, and I was there when we were at that peak, so it was a great time, indeed. So yes, look, you're absolutely right, there has been a change in consumer behaviour. And what we've seen, as the price of COE has risen, and as I think it was noted earlier in the call, it is still at very, very high levels, we have seen consumers typically trying to hold onto cars a little bit longer. And what you've seen people doing is revalidating COEs and holding cars for up to 15 years. That's now coming to the end of its cycle, but the effect of that does smooth out the cycle. I think the TIV in 2016, 2017 was around 115,000 to 120,000 units or so. We don't expect it to get back to that sort of level in 2026 and 2027, which will be the 10-year anniversary of that period of time, because of that smoothing cycle and that trend of people holding their cars for longer.

And as a data point, to give you a context of where we are at the moment, TIV for this year is about 35,000 to 40,000 cars. So that gives you a sense of the peak to trough that we are expecting in terms of the overall marketplace. And we're very well set to continue to deliver a very efficient and scaled business with a very attractive set of brands in that marketplace.

Duncan Tait: Very good.

Paul Rossington: Thank you.

Duncan Tait: Hopefully, that was helpful, Paul.

Paul Rossington: Yes, it was. If I may, one quick follow-up, as well. On HK and Singapore in particular, I know you have the full Toyota suite of products going into those markets, is there anything happening on the commercial side of the market that we need to think about beyond passenger vehicles? There's no major scrappage or taxi schemes or anything coming up in the near future or anything proposed of that nature? Thank you.

Duncan Tait: So Paul, just in terms of Hong Kong will make some announcements on EV policy for commercial vehicles and taxi during 2025. We are very, very well-positioned in the market accordingly with our taxi providers and light commercial vehicles. So the team are working on that. We were with them just, in fact, about three weeks ago, we were in Hong Kong and, as I've mentioned earlier on, we took our board to Hong Kong, as well. So nothing for you to think about in 2024. It's a 2025 onwards program. And nothing to say yet on commercial vehicles into Singapore. We'll update you as to our plans at our full year result in March, 2024.

Paul Rossington: Excellent. Thank you very much.

Duncan Tait: Okay, thank you, Paul.

Operator: Thank you, Mr. Rossington.

Duncan Tait: Very good.

Operator: As we do not have any further questions at this time, let me turn the call back over to Mr. Duncan Tait for any additional closing remarks.

Duncan Tait: Very good. Thank you very much, George, and thank you, everyone, for your questions. Thank you for joining. The third quarter was another strong quarter for Inchcape, highlighted by further strategic progress and good operational momentum across the group. This performance gives us great encouragement for the future. To that end, we look forward to updating you further at our full year results in March, 2024. And in the meantime, if there's anything else you need, please get in touch with Rob Gurner. Thanks, everybody. Goodbye.