Inchcape - Q1 2024 Results

Onsite Audio Webcast

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Transcript

Duncan Tait: Good morning, everyone, and thank you for joining us. I'm here with our CFO, Adrian Lewis, and Head of Investor Relations, Rob Gurner. I'll give an overview of trading in the quarter, our strategic progress and outlook. I'll then hand over to Adrian, who'll give more detail on our regional performance, and will take your questions.

First, on strategy, we recently announced an agreement to divest our UK retail operations to Group 1, the US dealer group, for a cash consideration of £346 million pounds. This is expected to complete in the third quarter. This transaction will complete our strategic transformation into a pure play distribution business, which is capital light, highly cash generative, higher margin, and globally diversified. When proceeds are received, we intend to conduct a £100 million pound share buyback. And as a result, UK retail will be treated as a discontinued operation. And we will focus our comments today on the performance of the distribution business in the first quarter.

We delivered a positive start to the year, with continued momentum across APAC, further outperformance across our Europe and Africa region, and key markets stabilising in the Americas. Reported revenue growth was 5%, and the organic revenue growth was 6%. This performance is another demonstration of the resilience and diversified nature of our business. We made good strategic progress, with several contract wins, to help build market share in existing markets and develop our OEM partner portfolio globally. Contract wins included Ford in Estonia and a Chinese commercial vehicle brand, Forland, in Ecuador. We also made further progress in building a robust pipeline of additional contracts and there was positive contribution from recent distribution contract wins. Last year's acquisitions in APAC also made a positive contribution in the quarter, and we are already seeing good commercial and operational benefits from the integration of these businesses.

Finally from me today, onto the outlook, where we are reiterating the position communicated earlier in the year. From our continuing operations, we expect a year of moderated growth in 2024 at constant currency. We are confident about the medium to long-term, and continue to expect a return to higher levels of growth, supported by recovery in many markets. With our global market leadership, disciplined approach to capital allocation, digital and data capabilities to support our OEM partners, and our highly cash generative characteristics, Inchcape is well positioned for the future.

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. During the period, our continuing operations delivered a positive performance, particularly against tough comparators. The group generated £2.3 billion pounds of revenue, up 11% at constant currency, with 6% organic growth, and a 5% contribution from acquisitions. These factors were partly offset by translational currency headwinds of 6%, which meant reported growth was 5% for the quarter.

Now, let me give you some colour on each of our regions. In the Americas, key markets were stabilising in Q1, consistent with the trends of the second half of last year. And across Central America, we continue to see both market momentum and outperformance. In Asia-Pac, the strong momentum seen in 2023 was continued, with broad based growth across a number of markets, including Hong Kong and Singapore. The region also benefited from the contribution from the acquisitions we made last year. In Europe and Africa, the region outperformed, with accelerated supply supporting an order bank unwind in certain markets in Europe against a backdrop of muted new consumer demand.

And as Duncan mentioned, we have agreed to divest our UK retail business for a cash consideration of £346 million pounds. And on completion of the deal, we will initiate a £100 million pound share buyback that we expect to complete within 12 months. The remaining proceeds, together with organic cash flows, will continue to pay down debt and reduce leverage as we create capacity to invest consistent with our capital allocation policy. But, importantly, we will maintain a disciplined approach to those investments. So to summarise, our performance in Q1, the group delivered a positive start to the year, highlighting the resilience and diversified nature of the business. And I think, George, we're ready to take some questions.

Operator: Thank you very much, sir. Ladies and gentlemen, as a reminder, if you wish to ask any audio questions, please do press *1 on your tap on keypad. And just, again, limit yourself to two questions. Our first question coming in is from Arthur Truslove, calling from Citi. Please go ahead.

Arthur Truslove: Hi, Duncan and Adrian. Congratulations on good trading update. So a couple from me, if I may. So, Adrian, you mentioned in your pitch that the comps were difficult in Q1. Please could you just run through the key comps that were tough, and can you tell me, or tell us, when you think some of those are going to get more straightforward? And second question, obviously the Japanese yen has been weak, and are you able to talk a little bit about the potential contribution from transactional foreign exchange as we progress through the year and what we've seen so far? Thank you.

Duncan Tait: Good morning. And as you threw those at Adrian, I will hand straight to him.

Adrian Lewis: Thank you, Duncan, and thank you, Arthur. Difficult comps in Q1. So let me go around a couple of the different regions where we've seen some difficult comps in Q1. So let's start in the Americas. We saw Q1, in certain markets in Southern Latin America, particularly Chile, skewed by a very positive and inflated market position, largely due to legislative changes that came in the spring of last year, in about March, and inflated Chile significantly. That was largely a pull forward and you saw a much weaker Q2.

I think the comments we've made about stabilisation in Americas, and as we said in our notes, refers really to a stabilisation versus the momentum we saw in the second half of last year. When you look through the lens of seasonality, we're seeing those markets continue with the momentum we saw towards the back end of next year. And I think our position that we've assumed of a flat year-on-year market is an appropriate one. So I think by virtue of those comments, you should expect those year-on-year metrics, given the baseline did bob around a wee bit, particularly in Latin America, to improve as we move forward.

In terms of the transactional FX movements, look, Arthur, we've talked in the past about how FX and transactional implications of those are part of how we think about the cost of vehicles, and about how our hedging position protects us over time, against adverse movements in those FX. So I wouldn't call a significant upside, nor would I call a significant downside risk in the future from FX strengthening or weakening. Because, ultimately, in a free market world, those things end up in price and our position would be the same. So the other thing I would say, just from a JPY, just for the sake of clarity, we don't actually sell anything in JPY. So that it's not part of our translational headwind that we noted in the top line.

Arthur Truslove: Thank you. Just to confirm on that, obviously you buy stuff in JPY, don't you?

Adrian Lewis: Yeah.

Arthur Truslove: So I guess my point is, for instance, Subaru in Australia, you would think you're selling in Australian dollar, buying in Japanese, maybe short term there is a tailwind. I appreciate over the longer term you iron that out, but is there any reason to think there isn't a short term, relatively small tailwind there?

Adrian Lewis: Arthur, again, yes, there is a reason to think there wouldn't be because we take hedging positions which smooth out those volatilities, both positive and negative. Because there's a downside to taking a hedging policy, but we think it's appropriate to give ourselves time. And, look, ultimately, we're not the only one buying in Japanese yen and selling an Aussie dollar in that market and it's a free market. And we see those things flowing into the value of vehicles in the market. So to be very clear, there is not a margin tailwind from those short-term movements because of the hedging positions we take.

Arthur Truslove: Thank you, that's very helpful.

Duncan Tait: Thank you, Arthur.

Operator: Thank you, sir. Ladies and gentlemen, as a reminder, if you wish to ask any audio questions, please press *1 on your tap on keypad at this time. We do have Andrew coming back with a follow-up question, one moment, please. Mr. Nussey, your line is open, please ask your question.

Andrew Nussey: Right, okay. Morning, everyone. A couple of questions from me. First of all, if we look into APAC, can you just give us a little bit more detail around the Singapore market, and particularly what you're thinking or seeing, in terms of the certificate entitlements and the impact that that will have on the performance through the course of the next couple of years? And, secondly, I'll see two new distribution deals, as you touched on, Duncan. I wonder if you have any insight to the pipeline on new distribution transactions, and whether there is any sign in terms of increased outsourcing of national centres or, equally, whether that's winning share from existing distributors? Thank you.

Duncan Tait: Very good, thank you, Andrew. Listen, I'll take those questions. So just, in Singapore, we saw a 16% sequential increase in COE availability in the fourth quarter of last year. And I'll remind all of us that Inchcape with Toyota was the leading market share player in Singapore last year also. So good momentum towards the end of the year. We've seen that continue into the first quarter and, in fact, accelerate a little bit. I was very pleased with our order intake in the first quarter in Singapore. And it looks like, subject to supply availability for our OEMs, the Singapore market will be slightly better than we had planned for this year. And we had planned for a reasonable scaling of that market in 2024.

Now, if you think about that COE cycle, where the bottom end of the market is about 35,000 units per annum total in the market at the low end to a high end of above 100,000, we are absolutely on the uptick or the scaling up of that market in Singapore for us. So we're climbing through the foothills. Growth is very nice and that will last for a few years yet, I think, towards the end of this decade before you get to the peak of the COE cycle. But for the avoidance of doubt, we are definitely on the up cycle in Singapore, and we're riding it very nicely and I'm pleased with our order intake.

In terms of distribution deals, so, look, a pleasing start to the year with some new distribution contracts in Europe and the Americas. We have more that we are in the final stages of negotiation for, both in APAC and Europe and in the Americas, so a pleasing pipeline. I think I said earlier this year, I don't expect us to get back to the 15 deals we did last year, but high single digits would be a nice place for us to be. And we'll have some more news, later in the year, as to where we are with distribution deals.

And I think there are opportunities to convert national sales companies from OEM ownership into Inchcape ownership through some contract wins and others. And if I just give you a sense about it, we are winning some which are completely new. So Forland in Ecuador is a new deal for us. Ford already operated in the Baltics, and we've now taken Estonia. So I think there's opportunities, whichever way I look, in whichever region, there are more opportunities for contract wins. And subject to valuations, there's also opportunities, Andrew, for us to continue to consolidate the market through acquisition.

Andrew Nussey: Got it. That's great. Thank you.

Operator: Thank you very much. Mr. Nussey. Ladies and gentlemen, as a final reminder, if you have any questions, please press *1 at this time. We do not appear to have any further audio questions at this time. I'd like turn the call over to Robert Gurner, who will now handle the questions submitted by the web. Thank you.

Rob Gurner: Thank you, George. Good morning, everyone. We've only got one question from an anonymous caller. "Can you explain why £100 million was chosen as the quantum for the share buyback and not a higher amount? Does this signal an intent to make further acquisitions?"

Adrian Lewis: Shall I take that one, Duncan? No, we think... Thank you, Rob. We thought that £100 million pounds was the most appropriate value to start with the share buyback. If I take us back to what we said at the full year results, where we reported a net leverage position of 0.8x in the context of a self-imposed limit within our capital allocation policy of 1x. We said that we wanted to use 2024 to, through the organic cash flows from the group, create some capacity in our balance sheet in order to continue to apply our capital allocation policy. And the UK transaction will serve to accelerate that. On completion of that transaction, that will, indeed, do that. And will create capacity and optionality in our balance sheet and in our leverage position in order to continue to deploy capital allocation. So we felt it was appropriate to start with £100 million, and we'll start it once the transaction has completed.

And, look, we've said on the call today, we're going to continue to be value disciplined around our investments and around our acquisition opportunities. Where we see synergy benefits, we see quite a lot of value in acquisitions. But we are also very mindful that our own shares are also attractive as an investment. So we will have capacity, we will have optionality through the second half. And we'll continue to apply the disciplines consistently as we've done in the past.

Rob Gurner: Thanks, Adrian. There are no other questions from the web. Back to you, George. I think there's other questions on the phone lines.

Operator: Yes, sir, we do appear to have two at this time. So right now, we will go to Akshat Kacker, calling from J.P. Morgan. Please go ahead.

Akshat Kacker: Morning, Duncan. Morning, Adrian. Just one modelling question on my side. When you think about net financial expenses for 2024, given that we are in an environment of higher for longer probably, and the Japanese base rate has also gone up, could you talk about how has that changed your expectations around net financial expenses, please? Thank you.

Duncan Tait: Good morning, Akshat. And that's definitely going to Adrian.

Adrian Lewis: Thank you, Akshat. Actually, I'll remind just that today as a trading update where we're talking about the top line only. I think what you should consider in terms of net financial expenses, in the context of our PBT guidance where we have reiterated our guidance for the full year, you'll see more about how the lines within our P&L are revolving over time. I think I'd say one final thing on JPY particularly. We have been consistent on the way through, that says, where we see interest costs as part of the structures that we work with as part of our OEMs. That's just part of the cost of the metal and part of our pricing structures. So both good and bad news flows through into those accordingly. So we'll say more, and you'll see more, in the detail of P&L. And I'll remind you that we're reiterating our bottom-line guidance today.

Akshat Kacker: Got it. Thank you.

Duncan Tait: Thanks, Akshat.

Operator: Thank you, sir. We now have a follow-up question from Arthur Truslove of Citi. Please go ahead.

Arthur Truslove: Thanks, everyone. So following on from the previous question, I guess one question I have is, what are the key reasons why you haven't been able to talk up consensus today? I guess, taking a high level view, your European business is performing ahead of expectation. It sounds like APAC is performing slightly better than you thought. And it sounds like LATAM is performing broadly aligned with expectation. At the same time, certain currencies have appreciated against the pound since you reported full year.

So I just wondered if you could talk a little bit as to why you haven't been able to increase your full year outlook today? Thank you.

Duncan Tait: Thank you very much. Arthur. Look, I'll try and make some comments to try and be helpful to your questions. So, look, we're only three months into the year. And, yes, we are making a positive trading statement today on the top line. We saw some FX headwinds in the first quarter. And I think it's a bit early for us to say whether FX will continue at a translational level to be a benefit or a disbenefit to us during the year. What I can tell you is we're focused on executing our business across those three distribution regions. We've made great strategic progress in the first quarter in our move to a pure play distribution business. And I feel really good about Inchcape, our OEM relationships, and the markets we're in.

A lot of the markets are still at relatively low levels. We're planning Americas flat, remember, for the year. And although there's some positive macro data coming out of the Americas, like another interest rate cut in Chile this month, it's a bit early to call the market up. And we think consumer demand will lag the drop in interest rates. So we feel good about our first quarter. The interims are only a few months away, when we'll give you a better sense of how we've seen Q2 and the year. But we feel confident about the business. And we're making really, really good progress. But we're only three months in.

Arthur Truslove: Wonderful, thank you very much.

Duncan Tait: Thanks very much, Arthur.

Operator: Thank you, sir. We'll now go to James Zaremba, calling from Barclays. Please go ahead.

James Zaremba: Good morning. I actually had a question on the retail disposal. Obviously, there was some strategic rationale in the past for keeping that. Part of that was the OEM relationships. And I think in the statement you said about how you were pretty pleased that your OEM partners felt it was a good deal for them as well. Obviously, I think in the UK, you had some brands which you didn't represent as broadly in distribution. Should we think that it's a little bit harder to win maybe distribution with those brands in the future, or is that a bit unfair?

Duncan Tait: Hi, James. Good morning. Look, so let me take that. So I think the backdrop to your comments is exactly right. The UK business gave us the opportunity to represent brands in our distribution markets. And I think Mercedes is a great example of that where, just a few years ago, we didn't have Mercedes distribution relationships. We're now the biggest distributor of Mercedes in

Latin Central America. And you know we're winning business with Mercedes in APAC, notably, what we've done in Philippines and in Indonesia.

Now, what we have done over the last few years, as you know, is we've sold £2.6 billion-ish of annual retail revenue, plus now the UK disposal. And at the same time, we have more than doubled the size of our distribution business since about 2019. So it is very clear what we've been doing. And during that period, of course, we're building really solid relationships at market level, regional level, and headquarters level with our key OEM partners. And I think it is a testament to the way the company's built our OEM relationships, being clear about strategy, which just has enabled us to simplify our portfolio and dispose of the UK business. And by the way, I think the UK business will be in great hands with Group 1. And our OEMs have been super supportive of Inchcape's move and, actually, at the same time, from what I can see from Group 1's move also.

Now, in terms of distribution business, then those OEM relationships, whenever Inchcape completes a transaction, we want our relationships with those OEM partners to be better the other side than it was when we started. And I think the disposal of the UK business is another example of that. So I expect to get really good support from our OEM partners to further grow our business, whether that happens to be European, American, Japanese, or Chinese OEMs as we grow our business.

The final point to note is, yes, you are right, if I look at an OEM like Volkswagen, say for the Porsche element of that, we don't distribute Volkswagen around the world. But in terms of that 17 million TAM, yes, it takes a little bit of a chunk out of that. But there's still a market size for us to go after globally of about 10 million units per annum in the markets that we focus on. And you know, we're only about 3% of that target addressable market. So with our existing OEM partners, and good markets we're in, the company is well positioned to continue to grow. James, does that answer... Is that helpful?

James Zaremba: Yeah, no, very helpful. Thank you.

Duncan Tait: Thank you.

Operator: Thank you very much, sir. We appear to have one more question at this time, and it is coming from Paul Rossington of HSBC. Please go ahead.

Paul Rossington: Good morning. Well done on the update today. A quick question on the outlook for LATAM. You're not banking on any particular recovery in Chile, Colombia just yet. But lower interest rates could stimulate more demand, but I'm also interested in the relationship between lower interest rates and your inventory financing costs in LATAM. I presume that if rates come down in LATAM and Chile, Colombia, that will be beneficial for your inventory financing costs as well. Just a bit of colour around that would be great. Thank you.

Duncan Tait: Good question, Paul. That's going straight to Adrian.

Adrian Lewis: Yeah, look, Paul, so let's tackle the first one around interest rate cuts. And you've seen the central banks in a number of our Southern Latin American markets act swiftly in reducing interest rates over the last six months or so with a number of steps down. We are relatively prudent about our expectations, in terms of the lag between those rate cuts, and how quickly consumer confidence returns, and how quickly we see consumer growth in terms of TIV. So we continue to maintain our relatively prudent stance of a flat market, in particular somewhere like Chile. We think that's appropriate. And, actually, if you look at what the external market commentators have said more recently, at around our full year results time, those market commentators were a little bit more optimistic than we were. Those market commentators have since updated and are more consistent with us around a flat market, year over year, in Chile in particular. So we think that's appropriate, and that lag, we don't expect to be a tailwind for 2024. Although, and look, we can all hope that there is a significant upswing in the second half, but we're not banking on it.

In terms of interest rate cuts and its implications on our inventory financing, look, well, I'd say a few things. Firstly, actually, the interest rates that are associated with inventory financing facilities are typically denominated in the country of purchase as opposed to the country of the market in which we operate. The delta, really, is in the hedging costs, and that hedging cost sits within gross margin. You'll see a bit more colour on this when we do our In the driving seat about how we manage that. But the big picture is both, similar to some of the questions I was asked earlier around FX, look, ultimately, all of this ends up in the way we think about pricing on vehicles. And, ultimately, the costs of hedging, the cost of inventory financing, all sit within the price of the vehicle. And all of the distributors and importers in the market are subject to those same factors. So I think you should ultimately think about there being an offset of any positive tailwinds in interest costs elsewhere in the P&L.

Paul Rossington: Just one more follow up. You talk about having 3% of the addressable market that you're operating in. Is that in value or in volume terms, when you talk about that 3%? So is it circa 300K volume sales?

Duncan Tait: Yeah, yeah. You're right, Paul. Yeah, it's about 300K units of what we think our TAM is about £10 million-ish. We'll give you more about that later on in the year as to how we think our TAM is evolving. So you'd have heard me previously talk about £17 million. We think the realistic number's about 10. So, yes, and that number is a volume number. We'll also share with you, later in the year, about how we think these markets are scaled, in terms of the pound value of distributing of new vehicles and the pound value of the potential after sales business too.

Paul Rossington: Excellent, excellent. Thank you very much.

Duncan Tait: Thanks, Paul.

Operator: Thank you very much, sir. As we have no further questions, I'd like to turn the call back over to Mr. Tait for any additional or closing remarks. Thank you.

Duncan Tait: Thanks, George. And thank you to everyone for joining us this morning. To summarise, Inchcape's made a positive start to the year. We've announced major strategic progress to become a pure play distribution business, and we remain well positioned for growth. Finally, as a reminder, and as Adrian mentioned just a few moments ago, we'll be hosting an In the Driving Seat webinar on Thursday the 23rd of May at 2:00 PM UK time to help provide a deeper understanding of our distribution model. In the meantime, please get in touch with Rob if you have any follow up from today's discussion. Thanks for joining us.