Company: **SODIC**

Conference Title: **SODIC Third Quarter Results**

Moderator: **Mai Attia**

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Operator: Good day and welcome to the SODIC Third Quarter Results conference call. Today's conference is being recorded. At this time I would like to turn the conference over to Ms Mai Attia. Please go ahead.

Mai Attia: Yes, good afternoon, everyone. This is Mai Attia from EFG-Hermes. We are very pleased to be hosting the Third Quarter Results Conference Call for SODIC today. We have on the call SODIC's Managing Director, Mr Ahmed Badrawi, Mr Omar Elhamawy, CFO, and Ms Heba Makhlouf, IR Manager. So I will just hand over the call now to Mr Badrawi who will start.

Ahmed Badrawi: Mai and EFG-Hermes, thank you very much for hosting and organising the call. And thank you all the attendees for listening in. I will try and be brief and to the point and just rather than to read out figures that I am sure you've already pored your eyes out over, is to try to put them in to a little bit of context of let's say the overall performance and direction of the business. I will talk a little bit more generally than just talking about the figures. And in the Q&A session please feel free to quiz me about any particular part – myself or Omar or Heba. But I would just like to make the introduction saying that really it's been a phenomenal year for SODIC, that we made major strides in the business and I believe that the business has grown by nearly every important metric that certainly we look at in terms of the growth of the land bank, the market cap, the sales, the receivables, the cash – even debt. I think in every way that we look at the performance of the business it has grown rapidly and dynamically. And I think that we are really extremely well placed to take advantage of, hopefully, what we'll have is some good tailwinds behind us in the coming period. I think we've built a great platform and hopefully we'll start to realise the benefits of that over the coming years.

I don't want to highlight let's say the successes of the year but I would just point to some major milestones that were achieved with the settlement of the Eastown land, with the acquisition of the new land, getting the loan that really enabled us to pay for the new land as well as now the final stages of concluding the capital increase. I think it's worth mentioning very early on at this point is that the machine is so well-oiled now that we are very well on course to launching the first phase of the new project in East Cairo before the end of this month. You will remember that we always said when we got the land back in May or June that we're aiming to do a launch before the end of the year. We're happily on course to do that and to really let's say achieve the business case numbers to have finished the master plans. We have finished the new prototype, the unit designs. I think it's a real testament to now how well, how smoothly running the machine is. And we're very excited about the project. We've got a relatively small launch maybe of 200 units or so that have a probable value of in excess of EGP 650 million. So that's going to be something that adds to already the strong performance of the company.

To-date our sales have already exceeded EGP 2.4 billion. I think the reported for the nine months was at EGP 2.15 billion that you'll see in the numbers. Since then we've launched a project in West Cairo called The Courtyards, about EGP 250 million that was also received very well with strong cash collections upfront and strong demand all around.

So I think that we're extremely pleased with the performance today. We consider that we're selling at a good premium to the rest of the market. You would have seen that in Eastown our prices achieved in excess of EGP 10,000 a square metre. In West Cairo we're around EGP 8,500 a square metre for the apartments. It's a big premium to the rest of the market and I think that's as a result of let's say the confidence that the market shows in SODIC quality and our commitment to delivery.

I'm very pleased with just generally how things are going. I should mention that in addition to the EGP 650 million launch of the new project in East Cairo, we're also working through existing inventory of about EGP 750 million, although some of those may be some heavy units, we expect to move some of those as well.

So let's say, on the sales side of things, things are very, very strong. Just to point to a few other things that I'd look at when I'm talking to my team and to Omar, and everything, our collections and delinquencies are very strong. Our delinquencies are at almost an all-time low of less than

4%. The cash that we're collecting today, this year we collected more than EGP 1.5 billion. That's a rate of more than EGP 125 million a month. I remember doing these calls many years ago when we were at a rate of EGP 50 million and EGP 60 million a month, so that's pretty much doubled over the last three or four years.

I think it's worth noting that we've had a couple of cash windfalls as well. You guys see the numbers of the P&Ls. We've also had about a EGP 100 million windfall of cash into the coffers of the company from an old ESOP scheme that actually materialised in Q3.

So we're sitting today on a cash balance of nearly EGP 1 billion of which let's say quite a substantial amount is committed towards the delivery of existing projects. But there is a good EGP 200 million or EGP 300 million there now that's free cash that can be used for expansion purposes for us. And that's before the proceeds of the capital increase come in. And I think it's been fairly well documented that the capital increase, two thirds of that is earmarked for the 301 project but the remaining third is also geared towards new opportunities. We're looking today aggressively at new opportunities, both new land outside of our let's say comfort zone of East and West Cairo. We're looking at discretionary second homes on the Coast. And we're also looking at commercial and retail projects both inside and outside of our existing lands. And I think as a strategy of the company is that we're very comfortable now with the residential let's say model and the residential product that we're able to bring and the premiums that we're able to command. And now we feel that both the market is ready for the slightly more let's say sophisticated capital-intensive non-residential side, and that our platform is also ready for it, especially in terms of the availability of capital that wasn't there in the last few years as well as the demand on the other side.

I would mention also that I think you will have all looked at the numbers for the third quarter and the deliveries and I think that you'll see that we're on Schedule II, I think more or less in line with the indicators that we've given to the market of deliveries and profitability for the year.

If I could talk a little bit just at this stage about not overly focusing on the quarterly earnings as a barometer of our performance. And I think I usually make this comment on the calls. And I think it's important to emphasise the point that the numbers that we're reporting or the quarterly earnings that we're releasing reflect a bigger reflection of the sales that happened in a historical period three years ago. So the revenue is being recognised on the delivery which happens let's say three years after the launch. And so I mean, the excitement for me that I'm looking at is really what the future earnings are and SODIC's ability to actually make those materialise. And I hope with the introduction that I've made that I'm giving let's say a positive sentiment about our ability to make sure that any of those revenues are delivered on time in the future. At the moment we're still working through, I think, five something billion pounds of unrecognised revenues from historical sales. Given the rate that we've been selling at the last couple of years of, let's say, averaging EGP 2.5 billion a year, this year hopefully getting closer to EGP 3 billion, projecting in the next couple of years to go up to the fours and fives is that everyone recognises that the real let's say performance and the real numbers are going to come a little bit further down the line. And I think that when we hopefully are able to complement those with the recurring revenue streams of the projects – some of which we've been working on already and many of which we're about to launch over the next few months – I think that the long-term health of the company is extremely exciting and positive.

If I was to mention anything else I would just look at the capex that let's say is slightly behind this year on the amount that we wanted to spend. However, we're still comfortably within the contractual delivery periods that we have to our clients. Our targets are always aggressive with a view to delivering ahead of schedule. This year we've had some operational challenges as you might expect in the environment that we operate in, but with the lifting of subsidies in July that led to a little bit of turbulence with our contractors and our suppliers and we had a period of running around where the suppliers were trying to work out what the impact was going to be on their numbers and that led to a little bit of a slowdown and some renegotiations and delays of new contracts. And ultimately let's say the resultant effect of all of that is that we did see some inflationary pressures and we've seen costs maybe go up by about 15% on the execution side of things – which is more or less in-line with inflation contingencies that we had. We've begun to see a little bit more pressure on some of our suppliers, for example, on the excavation works as a result of old work that's happening in Suez and some of the other work that's been announced by the Government. But generally, we continue to remain confident that our relationships with suppliers are good enough to make sure that we'll be able to continue to secure, basically, the services in the future years.

Other challenges in the business that we've been having relate to continued delays, bureaucratic delays with getting permits and DMPs and just general approvals in place – something that we're continuing to work on and continuing to spend a fair amount of effort on and hopefully we'll make some good strides going forward.

But really, I think I've covered most of the stuff that I wanted to bring to your attention with an overall message that the future, for the first time, that we're sitting down and trying to plan our projects with good long-term plans of five years with a fair amount of visibility and confidence in both, let's say especially, the economic macro stability, and pleased that I think we've shown in the last couple of years that even when we've had the political challenges and everything, is that our industries continue to perform. We believe now that as a lot of the fog lifts that the future for our industry and for this company is actually very exciting.

So that's the introduction that I wanted to give. If Omar wants to give any more numbers let's pass it, perhaps Mai, to the floor and address any questions on the numbers or otherwise. I'll pass it to you, Mai. Hello?

Operator: Ladies and gentlemen, if you would like to ask a question over the telephone, please press the star or asterisk key followed by the digit 1. Please ensure that the mute function on your telephone is switched off to allow your signal to reach our equipment. Again, please press *1 on your telephone if you wish to ask a question. We will pause for a moment to allow people to signal for questions.

Our first question comes from Patrick Gaffney from HSBC. Please go ahead, your line is open.

Patrick Gaffney: Hi, thanks for taking my call. I guess, could you give us an idea, I know that the margins were pretty low – the net margin in the third quarter and for the year, basically. Can you give us an idea of what you think the long-term net margin can be for the company? I totally understand what you were saying before about these are our sales that were done three years ago and the new sales will have different sorts of margins and also different deliveries. So if you could give us an idea of where you think margins will go and when they'll reach that.

Ahmed Badrawi: Thanks, Patrick. Yes. And just to emphasise the point of the accounting standard is that the gross margins actually show the actual cost reflected or are incurred with bringing that product let's say above the ground. But net margin actually shows the overheads that we're incurring today and so they're not matched. And that's why sometimes in these years where we're recording relatively depressed revenues, is that you're seeing that the net margins are significantly impacted.

So in terms of targets we're generally always targeting to produce gross margins of about 35% and to bring the net to above 20%. And I think that from next year we'll start seeing those kind of margins much closer to those targets. And next year we start seeing the deliveries from sales in 2012 and between the end of next year and 2016 I think you'll start seeing that.

Patrick Gaffney: Sure, thanks. In terms of capex spending can you just – or just overall spending – can you give us an idea of how much you have, I guess for the rest of this year and next year, both for the land and the contracts that you've signed so far for construction?

Ahmed Badrawi: Sure, Patrick, I will try. Generally we are aiming to try and get up to around EGP 700 million for the execution spend. And I think that the land liabilities for this year…

Omar Elhamawy: We have one more instalment for the new land which is about EGP 180 million, EGP 190 million that's due in December.

Ahmed Badrawi: Do you know the number for the year for the land?

Omar Elhamawy: For this year it will be about EGP 700 million in all that we paid in 2014. And 2015 we're looking at about EGP 750 million.

Ahmed Badrawi: Yes? Plus some of the others. But yes, I think it's around 8 – yes?

Omar Elhamawy: So yes, I'm talking about the 301.

Ahmed Badrawi: So it's around EGP 850 million annually is what we're paying on the land side of things at the current rate, Patrick.

Patrick Gaffney: And the EGP 700 million is something for the execution. Do you think that's stable?

Ahmed Badrawi: No, next year we're aiming to increase that significantly as we open up the new sites, as we open up to 301 and some more projects. So we'll be aiming to take that above the 1.1-1.2 level. So next year total spend in excess of EGP 2 billion is the target.

Patrick Gaffney: Great. And then in terms of how long you think your land bank can last now if you did not include other acquisitions?

Ahmed Badrawi: I think comfortably, Patrick, we're talking about EGP 16 billion to EGP 17 billion of sales at a rate of EGP 3 billion or EGP 4 billion a year. We're talking about let's say four years or so. And that doesn't take in to account that there is still quite a lot of commercial stuff that's outside of that figure that will keep us going, I think, obviously, longer than that. I touched on, in my introduction, that we're now sitting on quite a tidy slush fund by where we're looking for new opportunities to replenish the land bank. And I think if I can spend a couple more minutes just talking about, maybe, our strategy on that, is that historically we've looked to the Government for providing us with land. We've considered that's the cleanest way to grow the land bank and to replenish our land bank especially in this past period where you had a lot of challenges on most of the land.

Going forward, that's not necessarily the strategy that we plan to continue with because we think it's a bit capital-intensive. And we think that today we've reached a situation in our maturity where we can leverage the platform and we're in discussions with many landowners. And that's something I know I've talked to you about in the past, that of trying to do co-development deals where you're not paying for the land and the development upfront and that you can stagger the land payments and agree whether they're revenue share-type arrangements or joint venture but that don't involve big capital outlays at the front. We're looking at those as growth opportunities for residential and using our existing capital more for developing commercial and recurring revenue type assets.

Patrick Gaffney: Great. Thank you so much for the time.

Ahmed Badrawi: Thanks, Patrick.

Operator: Thank you. As a reminder, ladies and gentlemen, if you do have a question at this time, please press *1 on your telephone keypad. We have no further questions at the moment. Pardon me, we do have a question now from Mohamed El Meniawy from Pharos Asset Management. Please go ahead.

Mohamed El Meniawy: Hi, everyone. Thank you for the call. I would like to ask you on the cancellation rates we're seeing in the third quarter. It's quite a large one compared to last year. We're talking about 10%, if I'm not mistaken, largely coming from Allegria. Is there any reason for that high figure?

Ahmed Badrawi: Yes, okay, just to cover that one quickly, Mohamed. Thanks for the question. We've been let's say aggressively trying to clean up some of the longer standing disputed things. We had a lot of cases that had fallen in to legal disputes that we've been unable to transact on. So in this last period we're actually able to clean up a lot of those legal cases and get the properties back, put them on to the market and resell them and therefore clean up the delinquencies resulting in those – I wouldn't call it anything of concern – slightly high cancellation rates. But ultimately we're getting properties back at the old prices and listing them back at the new prices and selling them very quickly so it's actually been a profit centre for us.

Mohamed El Meniawy: Great, excellent. And my last question, if I may, is regarding the piece of land adjacent to Allegria. Are you still acquiring this land or what are the dates currently?

Ahmed Badrawi: Adjacent to Allegria, the one next to us here?

Mohamed El Meniawy: Exactly.

Ahmed Badrawi: In West Cairo. Definitely, let's say we focused our expansion the last one in East Cairo. That's where we saw that there was some real strong momentum and we started seeing a little bit of a premium on East over West. But we're strong believers in West Cairo. We're today 93%, 94% developed of our land here so literally we've got only 500,000 or 600,000 square metres to go which we have to finish up in the next couple of years. We're very keen to acquire new lands this side as well. The one I think that you're referring to that's virtually adjacent to our Allegria one would appear to make a lot of sense. It hasn't been released by the Authorities yet. I think they've been in a dilemma whether to release it in one shot or to divide it up in to several plots. I think there's talk about dividing it in to four plots. But we've been in close discussions with them over the past period. They've got very exciting and ambitious plans for the remainder of their land in Sixth October, I should have said, and we hope to be an integral part of those plans. I think that we believe that the track record that we've displayed in producing the highest quality projects in West Cairo is undisputed and we hope that we're going to be actually actively sought to participate in these new projects – and not just on the old basis of auctions. There is talk of partnerships and revenue shares and various forms of cooperation that's very attractive to us.

Mohamed El Meniawy: Okay. Thank you very much for your time.

Ahmed Badrawi: The next one.

Operator: Thank you. Again, ladies and gentlemen, if you have any questions at this time, please press *1 on your telephone. We have no further questions at the moment.

Mai Attia: Okay, thank you very much.

Ahmed Badrawi: Mai, thank you very much. Everyone thanks for the call and, as always, we are at your convenience, Heba, Omar and myself. Whether technical or general questions we are always available to answer anything you need. I think most of you can contact us directly.

Heba Makhlouf:Thank you, bye.

Operator: Thank you. That will conclude today's conference call. Thank you for your participation, ladies and gentlemen, you may now disconnect.