Company: **GB Auto**

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Operator: Good morning. Good afternoon, ladies and gentlemen. Thank you for joining our fourth quarter 2-16 results presentation conference call. Today's conference is being recorded. From GB Auto, we have Dr Raouf Ghabbour, CEO, Mr Mustafa Al Mahdi, CFO, and Mrs Mena Sadek Mrs Mena Sadek, CIO presenting fourth quarter and full year 2016 results. I will hand the call over to Dr Ghabbour for his presentation and we will have a Q&A session. Dr Ghabbour, please go ahead.

Dr Raouf Ghabbour: Thank you, Kris. Good afternoon, ladies and gentlemen and thank you for joining our fourth quarter results call. With me here today are Mustafa and Maggie, our Chief Financial Officer and Mena Sadek, our Chief Investments Officer. I'd like to keep the focus of my remarks today more strategic and on how after an exceptionally challenging year, we came out on top with double-digit revenue and market share growth. We headed into 2016 knowing that it was going to be a challenging year and our strategy throughout the year was guided by two key assumptions based on that fact.

First, we saw our competitors would lack the financial resources needed to secure inventory as the gap between the parallel and official foreign exchange rates widens. We also believe that those who might have had the resources would like the confidence to pass on price increases. This fuels our decision throughout 2016 to aggressively secure the foreign exchange require to build up inventory and price our products accordingly. And for the first ten months of the year, much of this foreign exchange burden was reflected in our accounts.

So from the first week of January throughout – through the end of October, we raised prices of Egyptian passenger cars by an average of 40%, at the same time, the decision to continue replenishing our stock within demand models and product allowed us to serve the markets when others came up short. The results speak for themselves. Our revenues grew 24% year on year and we captured an all-time high market share of 45% in April 2016, closing the full year at 36.8% versus 26.8% the year before. In the final months of the year, we knew though that sales momentum would not last. It was the question of when the float would come and not if. That day of reckoning arrived on the 3rd November 2016. Having passed on to our consumers, the lion share of the two cost of foreign exchange throughout the year, we raised prices only about 15% on average between the 3rd November and the first days of March 2017.

As we did, unit sales fell from almost 5,800 cars in October 2016 to about 2,600 units in each of November and December, and into a drop[?] in demand of just over 200 vehicles in February 2017. Our view was that approximately 15% price hike between the 3rd November and the first days of March had not brought us to the point of price in elasticity[?]. We believe the market was paralysed as consumers and business both adapted to the shock of a significantly weaker Egyptian pound. This view was first supported[?] by the performance of our motorcycle and three-wheeler segment. Sales declined from 9,000 units in October to about 2,000 in November, but they quickly recovered to around 5,000 units in December that gave us our first sign that the consumer demands would come back.

That's why we decided to test the waters and rolled out discount pricing in a special sale, the first week of March. We cut prices temporarily by an average of 10% to 15% across our passenger car portfolio and customers quickly returned to our showrooms. This was despite cars still being priced at the premium to the sticker prices in October when we sold nearly 5,800 units. Nearly five months into our new economic reality, I'm now seeing very clear signs that Egyptian consumers are still long term and enthusiastic buyers of passenger cars, motorcycles and three-wheelers. At the price of short term paid, we have gained a new healthier year outlook on our core market. We remain consciously optimistic about the resilience of the Egyptian consumer and the prospects of our business. Meanwhile, throughout this period of recovery, our other lines of businesses – of business, are acting as shock absorbers, commercial vehicle and construction equipment aftersales and our financing business and tire business continue to deliver solid performances after the float and throughout the first three months of this year. We believe they will continue to provide an important cushion as our Egyptian passenger car business recovers. Broadly speaking, we are guiding that we should start to return to normal run rate sometime in the third quarter and this comes with a couple of reservations.

First, it's important to remember that we are still holding back inventory to our network of independent dealers. This means it will take time for our inventory levels to normalise, so our emphasis on the inventory management front has shifted from pricing, the cost at which we source goods, to bringing inventory back down to historical days on hand. In other words, cash generation is our priority.

Second, we think there will be foreign exchange volatility throughout this year and into 2018. This means that profitability will fluctuate in line with the foreign exchange rate. As a result, we'll be guiding you to keep a close eye on our operating profit in the period to come, which will be a more accurate indicator of our performance.

With that ladies and gentlemen, I'd like to thank you all for joining us here today and will now hand the call over to Mustafa who will recap on financial performance, then, I will then provide some more colour on both our results and outlook for the year, then we'll open the call to your questions. Mustafa, please.

Mustafa Al Mahdi: Thank you, Dr Raouf. Ladies and gentlemen, GB Auto show an annual sales revenue increased more than 24% year on year in 2016 due to our inventory management drivers and our competitive pricing strategy in the inflationary environment. The fourth quarter was pressured by November float of the Egyptian pound, and the downward pressure it had on demand.

But while volume spread compared to [inaudible] Japanese across our division in October, we've closed the quarter with 52.9% year on year increase in sales. The gross profit level top line gains were [inaudible] with improvement gross margins for both the quarter and for the year, supported once again by our powerful pricing strategies, gross profit margin for full year at 14.4% up by 1.3% over last year.

Operating profits rose 59.2% year on year to 1 billion pounds during the full year. However, profitability was [inaudible] by foreign currency losses of almost 1.2 billion Egyptian pound. That most [inaudible] the non-cash expenses recording following the devaluation[?] of foreign currency exposure, which stood at 106 million Egyptian dollars – US dollars at the end of the year. We also recorded an increase in finance cost due to official interest rate increases reaching 642 million pounds in the full year, and incurred additional working capital requirements for day-to-day operations.

Following the devaluation in November, coupled with the weakened market demand cash levels with pressure, the company continued to accumulate the inventory while sales slowed down significantly. It is important to note, however, that our inventory building was part of our strategy to maintain the market leadership. We proceeded in doing that with our market share, shooting up over 56% for the full year. The group's net debt stood at 7.5 billion pounds at the end of the fourth quarter and increased 1.5 billion Egyptian pounds compared with the previous quarter. We maintained net debt [inaudible] of about 1.5 times at 31st December compared to 1.4 times at the end of September 2016.

Total consolidated debt increased to 8.7 billion pounds compared to the third quarter of the year, which includes 2.5 billion pounds in finance and business debt as we continue to expand our healthy financing operation. Overall, we maintain our strong market position compared to others in the market, and we continue to do so despite higher than usual inventory in the end of the year. We expect to return to the normal levels of inventory capital in a couple of quarters as cashflow levels are set to improve significantly over fourth quarter of 16 and first quarter of 2017 with reducing our inventory levels.

That concludes my presentation today, ladies and gentlemen. I'm going to hand the call now to Mena Sadek, our CIO who will provide you with a bit more insights into our margins before opening the floor for your questions. Mena?

Mena Sadek: Thank you, Mustafa. Ladies and gentlemen, I know you're anxious to open the floor for questions, so I'll try to be very brief. That said, I want to zero in on operational profitability for just a moment. The impact of 2016 starts near the top of our income statement with the effects of foreign exchange on our cost of goods sold. In parallel to raising our prices throughout 2016, we also embedded higher cost associated with sourcing foreign currencies in our cogs[?] throughout the year 2016. This was not the case during 2015 when all our foreign exchange expenses were reflected below the line.

Ultimately, while our actual gross profit margin came in one percentage higher than the previous year, it does not capture the extent of the improvement as we're simply comparing apples to oranges. This is also true as we move down to operational profitability and as you all know, the Central Bank of Egypt's hiked the interest rate by more than 500 basis points over the course of the year, with incremental rises throughout the year and a 300 bps hike post the float. This came at the same time that we made increasing use of our available facilities to finance our build up inventory, and resulted in us booking higher than normal interest expenses for the year.

What's more, this effect was even more pronounced in the final two months of the fourth quarter when our sales momentum flowed rapidly after the float. And finally, as Mustafa noted, we booked a total of 1.2 billion pounds in FX losses owing largely to the devaluation of foreign currency denominated liability. Setting aside the majority of these, which are non-cash, GB Auto would have delivered a positive profitability notwithstanding the FX component on our cost or the higher interest rate.

This is not to say that things had returned to normality in the first quarter of the year, our inventory levels are yet to peak by the end of Q1, you are yet to see increased debt levels again by the end of Q1 but as Dr Raouf noted as well, volatility in the exchange rate will continue to be a factor that we have to live with. However, we do see that the market is coming back to life. We do see that consumer sentiments has partially improved, but we are moving inventory as we speak today and we expect relief to start kicking in, in the second quarter, so by the third quarter of the year, we should be approaching normal run rate.

In the meantime, our lines of businesses such as commercial vehicles, tires, etc, they continue to perform very well as Dr Raouf mentioned as well. This provides a cushion as we see our passenger car line of business recover. And I want to confirm that our focus at this time would remain on instilling better cash management practices and looking at our different lines of business from a return on invested capital perspectives and this is something we're committed to and currently working on.

Finally, regarding our investment, we are very cautious when it comes to new CapEx spending, however, we are committed to our first of its kind two and three wheeler manufacturing facility and we are still awaiting the word of [inaudible] to start construction. On the PC front, we remain confident in the Egyptian government's commitment to a real automotive sector in Egypt and we patiently await the automotive directive on that front.

Thank you again, ladies and gentlemen. Now, let's open the floor to your questions. Operator?

Operator: Thank you. If you'd like to ask a question, please signal by pressing *1 on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, press *1 to ask a question. We'll pause for just a moment to allow everyone an opportunity to signal for questions.

And we do have our first question from Amayan Wafi[?] with Renaissance Capital. Please go ahead.

Amayan Wafi: Hi, everyone, and thank you very much for the call. So I will have mainly three questions. First one will be on the automotive directive that you just mentioned, you know. Any colour on the expected timeline?

Second question is regarding a detailed view on the margin performance of the commercial vehicle segment and tires. I noticed it has improved significantly in 2016 compared to the previous year. Is that something durable? Is that something we can expect to rollover going forward? And can you also give us the more colour on the key drivers of these improvements?

And the last question will be on the impressive market share performance that I noticed that the Chery model recorded during the year as I understand it is its first year of distribution. So after the first year, a 6% market share is quite impressive. So any colour on that as well? Thank you very much.

Raouf Ghabbour: Yeah, thank you. Regarding the automotive directive, actually, the government has done disputes[?]. The government has released it to the parliament. It is currently at the parliament and the parliament industry committee is forming meetings, almost daily meetings, with all the players for others not only in the automotive but as well the importers of cars, as well the automotive component manufacturers of cars. They're listening to everyone. We have delivered to them our comments and our vision about the future of the automotive industry. And I – the feeling I have is that they are extremely serious in adopting the new directive especially that the strong man in the parliament today, who is the head of the coalition called the –

Mostafa El Mahdi: [Inaudible].

Raouf Ghabbour: [Inaudible] –

Mostafa El Mahdi: [Inaudible].

Raouf Ghabbour: – support of Egypt, which is a coalition representing two-thirds of the parliament. He is, at the same time, the chairman of the Egyptian federation of the industry and he's the man who really believe in the potential of Egyptian industry and we fight very hard for it. So I do not see a problem but I see it happening. But I wouldn't really be able to comment on the tire business [inaudible] my control. But I see it happening this quarter. I really hope the – I mean, of course, the second quarter[?].

Second, with regarding margins of commercial vehicle and tires, margin of tires in 2016 was very – although you – it looks brilliant but it was very, very negatively impacted by huge storage and damage[?] charges because tires is looked upon as important product. So the banks were not allocating foreign currency. So in many cases, we were receiving huge volumes of tires in the port and we were not able to receive the documents because the foreign currency was not there. So if it wasn't for that problem, the margins which look brilliant would have been far better.

So I think for the tire business, you will see a sustained high level of profitability going forward. We don't have – and you will see, an increase in volume as well because we are adding more and more representations to our portfolio. This year, we have added – I don't remember, maybe one or two representations so far and we are still discussing with others. So I see enhancement in volume and margins for the tires business.

It doesn't apply to commercial vehicle. Because in commercial vehicle, the enhanced margins you are seeing is the result of – we had stock of goods, which was financed as cheaper foreign exchange rate. So we enjoyed – we priced at the current rate and we enjoyed better profitability but this is not sustainable to – it has – it will have to go down to the levels of the 15% or 16%.

The third question was about market share of Chery. Actually, 6% is not fair because we started selling Chery as of second quarter 2016, so the 6% and you should annualize, it will become 8%. I'm very confident, Chery will deliver far better market share this year because, number one, it is going to be a full-year versus three quarters of a year, number two, it's going to be the second year and the customers are really confident about the car and the current gaining traction[?].

Amayan Wafi: Okay. Very clear, thank you so much, Dr Ghabbour.

Raouf Ghabbour: Yes, thank you.

Operator: Again, press *1 to ask a question. And we'll take our next question from Hedwell Azmazri[?] from Arab African Investment. Please go ahead.

Hedwell Azmazri: Hi, I want to – and thanks for holding the call. I just had a question on pricing for this year. We've heard there're some price cuts since the beginning of the year. Have you envisioned any price cuts and what's your strategy of pricing for the rest of the year?

Raouf Ghabbour: I didn't hear you.

Hedwell Azmazri: Can you hear me now?

Raouf Ghabbour: Yes.

Hedwell Azmazri: My question was on pricing for this year. We've heard about some price cuts in the market. Have you engaged –

Raouf Ghabbour: Price cuts, yes.

Hedwell Azmazri: – in any price cuts and what's your strategy on pricing for the rest of the year?

Raouf Ghabbour: Okay. We saw the market demand declining continuously from the day of the floatation. Let's say from the beginning of November and December was even weaker and then January was weaker, and February was the weakest. At that time, of course, we did not know whether this was a psychological shock because of the new reality of prices or whether this was a speculation from the customer side because the customer was seeing, especially in February, the dollar rate – the dollar losing value versus the pound or whether it was really cash flow problem or whether it was the three factors combined together. So we decided to wait until the time when the customers will the see Egyptian pound losing value again versus the dollar, and that was at the beginning – actually, on the second of March.

So by the 2nd March, we felt that at least to other factors has been – is now playing games in our favour. So the speculation is going to be in our favour now. And we applied price discounts which brought the price level close to – not at the same level, but close to the level at which the market was still very active. So let's say, for example, [inaudible] cash was still very active at the level of 135, 140, and now the price is 180. So we brought down the price to 150 hoping that, by this action, we are defeating the second factor which was the price shock or the psychological shock.

So I was really watching whether there was real cash in the market or not. Luckily, we discovered from the first week that the cash in the market is not the problem. So I have to say that my sales in February in passenger car in Egypt has at least 11 times my sales in February. And having said that, it is not really reflecting the situation or the potential because we announced the new prices the end of the day of 2nd March, it was advertised in the newspapers on the 3rd March, and usually for a passenger car transaction, to take place, it's usually ten days to two weeks. So really, these 11 times volume improvement is for half the month. So this means that it could be 20 time or 22 times the volume.

I have seen the same happening in the two and three wheeler. In the two and three wheeler, the market or the volumes reduced to 1,000 units in the three wheelers – I am talking about three wheelers specifically, down from 8,000 units. We made the price adjustments a month before passenger cars. So we made a discount in the beginning of February. From 1,000 in February, I think we sold 3,000. This month, we will close at 5,500. So we are coming back very quickly with the volumes and this will, in itself, bring back not the profitability but it will bring back inventory level to normal I would assume by the end of Q3. You will see a peak of inventory and a peak of that end of Q1, which will very quickly in the six months, the following six months, go back to the very old level of 2015 which is almost [inaudible] with the exception of [inaudible] which is the strategic decisions we have been doing.

I hope I answered your question.

Hedwell Azmazri: Yes, thank you.

Raouf Ghabbour: Thank you.

Operator: Once again, if you'd like to ask a question, please press *1. And we'll take our next question from Malik Adib[?] from Bellevue Asset Management.

Malik Adib: Hello. Thank you very much for your time. I just have a brief question on the FX loss. I assume the FX loss is related to some payments in foreign currency you have to make, and it will depend on the fluctuations of the effects and the time at you will have to pay these amounts. Can you just let us know maybe on average when are those – these payments in foreign currency due and whether you have any flexibility there to eventually maybe benefit from a strengthening of the Egyptian pound? Thanks.

Mostafa El Mahdi: Sure. Roughly, when the fluctuation of the Egyptian pound took place on 3rd November, the difference in the price of the Egyptian pounds or the rate Egyptian pounds towards the US dollars was almost – we lost EGP9 to EGP10 per US dollar. We have two parts of forex loss. But related to financing the actual transaction, with the difference rate and the book rate from our market, which is already recorded, and the other part is relating to retranslating your monetary assets and liabilities dominated in foreign currencies which, at the end of 2016, was around $100.6 million, which was up almost the 1.2 billion loss.

Normally, for the payables, this is the [inaudible] actually and between 90 and 100… The minimum of it will be at a – and he settled then three and the majority in six months will be settled in six months.

Regarding the banks that's have different due dates to certain debt amounts, we will gain the Egyptian pounds to get stronger again with the US dollar. Part of this forex loss will be reflected to the forex gains.

Malik Adib: Okay. Thank you very much.

Mostafa El Mahdi: You're welcome.

Operator: If you find your question has been answered, you may remove yourself from the queue by pressing *2. And we'll take our next question from Michael Salameh from Arqaam Capital. Please go ahead.

Michael Salameh: Hi, everyone. Thank you for the call. I just have a quick question. We saw that other reserves on your capital increase more than doubled. As a result of an FX gain, can you please tell us what is it exactly? Thank you.

Mostafa El Mahdi: You are talking about 3 million which 258 –

Michael Salameh: It was 1.1 billion. It went up to 2.5 billion. It's the other reserves in the shareholders equity.

Mostafa El Mahdi: The difference mainly comes from two elements. One, the CTA, which is cumulative translating of the foreign – our foreign operation in Iraq and Algeria, and this is because of the devaluation of the Egyptian pound and those operations are recorded in US dollars. And the other part coming from the new amendment of the Egyptian accounting standard number 15, which allow us to [inaudible] part of our fixed assets except building and lands[?] using a certain indexation which were calculated based on the different index change rate of the US dollars against the Egyptian pounds, which results to 300 million.

Michael Salameh: All right. Thank you.

Mostafa El Mahdi: You're welcome.

Operator: And we'll take our next question from Michael McGaughy from Fusion Wealth Management. Please go ahead.

Michael McGaughy: Yeah, I have a quick question on your – the debt levels. They – both short-term and long-term debt increased a lot year-over-year. How much of that – well, you have about 8.7 billion with the debt now. How much of that is used for financing and how much is that – you know, how much of that is just for the other operations?

Raouf Ghabbour: Financing is 2.4 billion at the end of last year and the rest is for automotive. Long-term financing is specifically related to high rents[?] business while automotive business is 99% short-term finance. The debt level of automotive business, you have seen it peaking in the end of Q4 because of the inventory level, which accumulated due to the low sales in November and December. And as I mentioned earlier, I'm just confirming that the peak of that level will be reached end of Q1 because, actually, we started moving the markets starting from March, from this month.

Finance businesses, the debt level should be continuing to grow exponentially. But we are addressing this issue through going into – a planning to do securitisation during the course of this year or some banks are discussing to buy parts of the portfolio so we see which is better for us. Yeah, [inaudible]. Okay.

Michael McGaughy: Okay. And just kind of a follow-up question, how much – what are you paying now on your debt? What kind of interest?

Raouf Ghabbour: How much – what?

Michael McGaughy: What interest rate are you paying on the debt?

Raouf Ghabbour: In Egyptian – that, in Egyptian currency, has increased by 5.5% during the last 12 months. So we used to pay about 11% or 11.5%. Now, it's almost 18%, a bit less than 18%. In US dollar, we pay anywhere between 4% to 4.5%. That – the extra 5% definitely translated into ballooning our finance charge for this year – for last year.

Michael McGaughy: Okay. Thank you.

Raouf Ghabbour: Thank you.

Operator: Once again, if you like to ask a question, please press *1. And there are no further questions at this time.

Raouf Ghabbour: Okay, great. Thank you so much. Ladies and gentlemen, thank you very much for joining the call today and I hope we'll be able to deliver more comforting news during our next quarter. Thank you.

Operator: This concludes today's call. Thank you for your participation. You may now disconnect.