Conference Transcription

Date of conference	**:**	**21 May 2013**
Conference title	**:**	**Ghabbour Auto – GB Auto 1Q13 Results Presentation**

CONFERENCE DETAILS

Conference Date:	21 May 2013
Conference Time:	14:00 GMT
Chairperson:	Raouf Ghabbour
Speakers:	Mr Mostafa El Mahdi

KEY:	
words in bold	Unsure if words heard correctly - please check
??	Words could not be distinguished
(Inaudible - ….)	Words that are entirely inaudible for the specified reason

Operator: Good morning, good afternoon, ladies and gentlemen. Thank you for joining our first quarter 2013 results presentation conference call. From Ghabbour Auto, we have Dr. Raouf Ghabbour, CEO, and Mr. Mostafa El Mahdi, CFO, presenting the first quarter 2013 results. I will hand over to Dr. Ghabbour for his presentation then we will have a Q&A session. Dr. Ghabbour, please go ahead, sir.

Dr. Ghabbour: Thank you very much, Mark. Good afternoon, ladies and gentlemen, and thank you for joining our first quarter 2013 earnings call. As we have noted in our earnings newsletter, GB Auto has reported an outstanding first quarter. In fact, it was our best first quarter ever, despite very challenging market conditions, particularly in Egypt. As you know by now, the first quarter is typically the slowest sales season of the year, making it all the more impressive that we were able to deliver top-line growth and improved margins.

Making this first quarter's performance even more of an accomplishment is the fact that the inflationary impact of devaluation is now being felt and players across the market are facing very real foreign exchange weakening. The result has been as we predicted. Consumers have far less discretionary income and retail sentiment is falling accordingly.

Throughout the first quarter we had reasonable good success passing price rises to the market. This was particularly the case with Tires, CKD Passenger Cars, and the Commercial Vehicle business and we also some success pricing the impact of devaluation into Spare Parts and our Motorcycle and Three-wheelers division.

We faced far more constraints in the CBU passenger car segment. On the CBU front, we have faced twin challenges. Although our models remain in very high demand, especially with the successful introduction of new models like the ix35, the erosion of consumer sentiment, as a result of devaluation, has come at the same time as the Japanese yen has devalued against the U.S. dollar. Net-net, the yen has eased in near lockstep with the Egyptian pound, giving Japanese imports a price advantage over Korean models for the first time in Egypt. Consumers, needless to say, are trending towards smaller, more affordable models.

That said, we have been here before. Being caught with overstock amid the slam in consumer sentiment is exactly the situation we faced when the global financial crisis spilled into the local markets in 2008 and early 2009. The difference is that, in March and April, we had much leaner inventory levels than we did in 2008 and 2009 and we have more ability today to shift sales to higher-margin ticket models. In fact, we have successfully liquidated our stock of CBU models and, therefore, anticipate reporting higher Q2 2013 CBU sales even if this comes at the price of a reduction in margins for some of these models.

As you have read in our earnings newsletter, this development is taking place at the same time as we are strategically withholding supplies of high-demand CBU models from the market. This has had, and will continue to have an impact on our market share until June ends. The present circumstances have given us an ideal opportunity to restructure our distribution strategy to skew in favor of our own showrooms and wholesale activities.

As I speak, we have 38 authorized dealers and another 400 sub-dealers. These sub-dealers typically buy wholesale from authorized dealers rather than directly from us. The way it works is that GB Auto sells to authorized dealers at a set discount to sticker price while we usually grant sub-dealers a discount that is 75% less generous than the one we offer to the authorized dealers.

With that in mind, many of our authorized dealers have historically taken the liberty of selling to sub-dealers themselves. We have not objected to this practice in times of high demand but in times of slight overstock and flagging demand, the balance of power shifts towards sub-dealers. Simply put, such circumstances give them new bargaining power in negotiations with dealers on the wholesale market. This impact on the pricing of CBU models became apparent in February, for instance.

To make sure we have full control over prices, going forward, we decided during the first quarter to provide authorized dealers with allocations that are only sufficient to satisfy direct retail demand only. Meanwhile, we are directly supplying the sub-dealer network with the same discount they have typically received. This essentially means that we will be taking over the wholesale market once this initiative draws to a close.

During the quarter, however, this meant that we had to restrain the supply of our products to the market and thus the reduction in our market share, as you have read in our earnings release, is, in fact, due to our own engineering. We expect this process of supply restriction to last about three months in total.

The outcome will be that we will have a more optimal strength of sales between our own channels including the retail taxi replacement and tenders, dealers, and sub-dealers. This will ultimately make the short-term loss of market share very worthwhile, as it leaves us fully in charge of the wholesale market and will, ultimately, be net positive for our margins. By the way, GB Auto is the first company to apply this strategy in Egypt.

Meanwhile, we continued in the quarter to make progress with our launch of Geely passenger cars and we expect to begin full-scale commercial assembly operations by end of this month. With the yen swinging in our favor, I'm pleased to report that we've made our first order for new Mazda passenger cars in just over a year. I expect Mazda to deliver new sales this year without any cannibalization of the Hyundai or Geely numbers.

Now, the other headwind is in Iraq. Beginning in the second quarter, we expect to see margins returning toward historical levels because of a change in the regulatory environment that will lead to our Iraqi subsidiary, cutting its direct sales to high-margin government distributors. As a result, I anticipate margins returning to the 2011 and early 2012 levels but I don't foresee any impact on sales volumes. On the contrary, we are anticipating an increased allocation from HMT and we believe that we'll be able to sell the additional cars, albeit at our old margins, as I just explained.

Our sales in Iraq have also been impacted by the temporary shutdown of the Northern Iraqi border to vehicle imports, since February 2013. This came as the authorities there were preparing to release new automotive standards. This had an impact on the first-quarter volumes but I'm pleased to report that we are in full compliance with the new standards and when the borders opened earlier this month, our imports resumed.

Now, I will take a couple of moments to touch on major highlights across our lines of business before turning the floor over to our CFO and then to your questions.

On the regional expansion front, I am pleased to say we expect to start commercial operations in both Algeria and Libya with our previously announced product range. A very positive development here has been the strong acceptance of the Geely cars in Algeria following a key automotive show, motor show.

On the Motorcycles and Three-wheeler side of the business, we reported a very strong first quarter but we expect slower sales growth in the second quarter following the imposition of additional custom duties on the three-wheeler, as well as the impact of devaluation. Meanwhile, the Boxer motorcycle continues to sell very briskly.

We continue to manage the Commercial Vehicles and Construction Equipment business through a down market. In this sense, the division's performance remains at or above expectations. Perhaps the biggest news in this segment is both the strong export prospects of our GB Polo product range and the planned nadir in production of a family of products including a microbus, a minibus, a tourist coach, and intracity and intercity bus.

Our Financing businesses continue to report strong performance. Drive Financing, our latest entry in this field, has proven itself able to penetrate the small but growing consumer financing and factoring markets. Meanwhile, our star performer, micro-financing business, Mashroey, is growing its base and profitability at impressive rates.

Finally, I'm absolutely delighted with the performance of our Tire business. In tires, we have reported our best quarter ever, as we continue to acquire new market share as smaller players and parallel importers retreat from the field in the face of foreign exchange concerns.

Ladies and gentlemen, I know I have dwelt on quite a number of operational challenges that we were faced with this quarter. I also know that the rest of the year will see us facing new challenges in our current and new expansion markets.

What I want to confirm is that I still see exceptional prospects for this business in Egypt and across the region. The current conditions are also not preventing GB Auto's talented management from pursuing new opportunities, be it through new product introductions or new geographies to be penetrated. I look forward to speaking to you at length about new opportunities in the future.

With that, I will hand the call over to Mostafa El Mahdi, our CFO, for a quick look at our financial performance in the first quarter. We will then throw the floor open to your questions. Mostafa, please?

Mostafa El Mahdi: Thank you Dr. Raouf. Good afternoon, ladies and gentlemen. Thank you very much for joining us this afternoon. As Dr. Raouf noted earlier, GB Auto reported very impressive results for the first quarter 2013. Our revenues and gross profits rose despite the challenges presented by the economic and political situation in our core market. This reflects a very strong financial performance of our Passenger Car, Motorcycle, Three-wheelers, Tires, and Financing lines of business.

The increase in gross profit allowed us to absorb higher financing costs, mainly due to the higher level of inventory and higher foreign exchange losses, as the Egyptian pound continues to weaken against the U.S. dollar.

I would also note that the first quarter saw a pressure on GB Auto's cash flow position. This was mainly the result of the Company opting to build up a higher inventory level to counter the ongoing depreciation of the Egyptian pound as well as build up an inventory of Hyundai CKD. This decision to our inventory days on hand increased about one

1.5 times compared to 2012 year-end levels, which were already higher than normal as the inventory-buildup strategy had already begun.

The temporary increase in our receivable days is the result of long cash collection items with our supplies to the Iraqi government. We expect an improvement in this issue, going forward, although this will let Iraqi margins to return to their previous normal levels, despite the higher volume of anticipated on the second largest market for our passenger cars.

Despite the increase of the Company's short-term debt to more than EGP2 billion as of 31 March 2013, up from EGP1.8 billion as of December 2012, we maintain a very healthy coverage ratio with an EBITDA and covered standing at more 3 times.

We continue to place a strong emphasis on measured growth and, thus, higher SG&A costs during the quarter reflects the additional new geographic as well as other higher costs associated with the rising costs of running of running our business on the back of the devaluating of Egyptian pound, among other reasons.

Our strong margins during this quarter, which absorbed the extra costs, merely reflects our current strategy of passing on most of the effect of devaluation to the end consumer as well as to pay off our long-term strategy of diversifying our products portfolio; a strategy which we intend to continue going forward. This strategy will continue to be supported by our sound balance sheet, which is a key differentiator for GB Auto. With that, we can move on to your questions. Thank you.

Operator: Thank you. If anybody would like to ask a question, you may now press the * followed by the 1 on your telephone. If you wish to cancel the request, please press the * followed by the 2. Your questions will be polled in the order they are received and there will be a short pause whilst participants register for a question. Thank you. The first question comes from Nadine Marroushi from Bloomberg. Please go ahead.

Nadine Marroushi: Hello.

Dr. Ghabbour: Hello.

Nadine Marroushi: Hi, Dr. Ghabbour. I have a couple of questions, if I may. The first is I just wondered if you might be able to explain the sales volume versus revenue. Sales volume decreased between the two quarters, 1Q 2012 over 1Q 2013, and yet revenue -- so, sales volume decreased, revenue increased and I wondered if that was due to the price increases that you mentioned that you passed on. And, either way, are you planning any more price increases, going forward? That's my first question. Perhaps, answer that and then I'll ask another question, if I may.

Dr. Ghabbour: Yes, go ahead.

Nadine Marroushi: The other question I had is what are your targets in Algeria and Libya once you start commercial operations there? How much are you expecting to sell? And, going forward, which are you expecting to be your strongest most revenue-generating markets in 2Q and in 2013, more generally? And are you planning on any new geographical expansions? Thanks.

Dr. Ghabbour: Yes, of course the sales volume reduced during the Q1 2013 mainly because of devaluation, price increases, which of course met some resistance from the consumers until they understood that the foreign exchange was -- we had to change our prices.

In the meantime, we started restricting supplies to our dealer network in order to be able to penetrate or replace them supplying to the sub-dealers. Although we needed to sell and although we could sell and there was demand but we chose to reduce the supply to the dealers to the level we estimated of their retail sales, in order to open the door for us to supply to the sub-dealers.

So, for those two reasons, our volumes were intentionally reduced from our side but, as a matter of fact, because the devaluation was almost 25% the prices increased 25%. So, the sales revenue increased although the volume reduced. So, I hope this is answering your first question.

Nadine Marroushi: Are you planning any more price increases, going forward?

Dr. Ghabbour: Of course we are following the foreign exchange. We have seen a spike to EGP8.0 level a couple of months ago which went down to the level of, I would say, EGP7.50 today. So, for the time being we are not planning further price increases but if the Egyptian pound goes weaker versus the U.S. dollar, we will definitely apply price increases.

Answering your second question, we have already paid our capital in the Algerian company. We are about to pay the capital into the Libya company within this week or next week.

Nadine Marroushi: What is the capitalization for each?

Dr. Ghabbour: Our share of capital is almost $23 million or $24 million dollars in Algeria and $12 million in Libya, both which already we have transferred. So, we are expecting to start operating from next month. The Algerian market is booming and already Geely is having a very great level of acceptance in the Algerian market. So, we expect Algeria to start strong from first day of operation.

Nadine Marroushi: What are your sales targets there?

Dr. Ghabbour: We are targeting, our budget is 1000 cars per month, to start with, in Algeria. It is almost -- I don't remember Libya at all. It's about 300 or 400 cars so about 5,000 cars Libya per year. But I expect Algeria could grow much bigger than our conservative business lines.

Future expansion, of course I need breathing space. I need to consolidate my position in Libya and Algeria before considering any further markets. But, definitely, in 2014 we will start looking for other opportunities and we might be doing, hopefully, if we find a good opportunity we would not hesitate to take it.

Nadine Marroushi: Will that be in the MENA region or elsewhere?

Dr. Ghabbour: I'm looking basically at the MENA region but we have almost covered in the MENA region. Tunisia is too small. Morocco is based on CPT. Syria is, of course, not the right time. And we do not have any intention to go to Saudi Arabia and (INAUDIBLE). So, basically, we would be looking at sub-Saharan Africa.

Nadine Marroushi: Why is Algeria booming?

Dr. Ghabbour: Algeria last year, the total market has sold 568,000 vehicles.

Nadine Marroushi: 563,000 vehicles?

Dr. Ghabbour: 568,000 vehicles.

Nadine Marroushi: 8, yes.

Dr. Ghabbour: It's becoming the biggest market in Africa.

Nadine Marroushi: It's becoming the biggest market in Africa for what?

Dr. Ghabbour: For automotive.

Nadine Marroushi: Right.

Dr. Ghabbour: It's a very rich country. They have reserves of exceeding $200 billion. The population -- the penetration level is very low and it's a market to be there now.

Nadine Marroushi: In the second quarter? The second quarter and in 2013, which country are they expecting to be your strongest, most revenue-generating markets?

Dr. Ghabbour: I think that the second quarter we see just the beginnings of Libya and Algeria. So, it's going to be only for one month out of the quarter. Still Egypt and in Iraq are going to be the star performers.

Nadine Marroushi: And in 2013, by the year end?

Dr. Ghabbour: If I talk about the second half of 2013, I think that Algeria will be at the same level as Iraq.

Nadine Marroushi: Same level as Iraq?

Dr. Ghabbour: Yes.

Nadine Marroushi: Right. Great. Alright. Well, thank you very much for answering all those questions. I appreciate it.

Dr. Ghabbour: Thank you so much.

Nadine Marroushi: Thanks.

Operator: Thank you. If anybody else has would like to ask a question, you may now press the * followed by the 1 on your telephone. If you wish to cancel the request, please press the * followed by the 2. The currently last question comes from Samir Murad from NBK Capital. Please go ahead.

Samir Murad: Hello, good evening, gentlemen.

Dr. Ghabbour: Good evening.

Samir Murad: Another three questions, if I may, Dr. Raouf. The first is you mentioned about the restructuring of the distribution in Egypt. You said that it will take three months. Was it complete or should we expect a couple of months still to go ahead?

Dr. Ghabbour: I actually meant the second quarter. So, we should be normalized from beginning of July so we still have a month to go.

Samir Murad: Okay. So the three months you meant the entire second quarter?

Dr. Ghabbour: Yes.

Samir Murad: Okay. Regarding Iraq, the change in regulation, will it in any way impact your volumes in Iraq in the second quarter? (audio interrupted)

Operator: Ladies and gentlemen, sorry for the delay. Just reconnecting the speaker into the speakers' room. Thank you. Now joining us in the Q&A session is Nadine Marroushi from Bloomberg. Please go ahead.

Nadine Marroushi: Thank you very much I just had a couple of follow up questions, if I may, for further clarification of what we said. You said that your paid-in capital, your share of the capital in the Algerian company is $23 million to $24 million. May I ask, what is the total capitalization of the company?

Dr. Ghabbour: We have 54% with this $23.5 million.

Nadine Marroushi: You have 54%? Right. The total capitalization --

Dr. Ghabbour: Libya, we have 60%.

Nadine Marroushi: In Libya, 60%. What will the total capitalization of the company be?

Dr. Ghabbour: $20 million.

Nadine Marroushi: In Libya $20 million. And in Algeria?

Dr. Ghabbour: $43-point-something million.

Mostafa El Mahdi: $43.5 million.

Dr. Ghabbour: $43.5 million.

Nadine Marroushi: $43.5 million. And am I correct in saying that in Libya you're entering with El-Bostan El-Zahbya Group and in Algeria with Group Rahmoune?

Dr. Ghabbour: (INAUDIBLE)

Nadine Marroushi: Yes. Right. Just to go over the numbers again. In Algeria you're budgeting the sale of 1000 cars per month, in the first year. Is that correct?

Dr. Ghabbour: Correct.

Nadine Marroushi: Yes. And that's the first year ending December 2013. Is that correct?

Dr. Ghabbour: Yes.

Nadine Marroushi: Yes. And in Libya, 300 to 400 cars per month?

Dr. Ghabbour: Libya, I don't remember exactly but it's about 5,000 cars a year.

Nadine Marroushi: 5000 cars for the year. Yes. Ending December 2013, okay.

Dr. Ghabbour: (INAUDIBLE) it means 300 cars a month or 400 cars a month.

Nadine Marroushi: Yes. Okay. You said that, by the second half of the year, by H2 you're expecting Algeria to be at the same level as the Iraq. Can you just explain what that means exactly? What level would that be?

Dr. Ghabbour: I didn't say the same level. I said that star performers (INAUDIBLE)

Nadine Marroushi: Sorry, I didn't hear that. The line wasn't very clear.

Dr. Ghabbour: I didn't say the same performance as Iraq. I said star performer like Iraq.

Nadine Marroushi: Right.

Dr. Ghabbour: It's going to be a success from day one. That's my expectation.

Nadine Marroushi: Can you put a figure to how much you expect the start of operations up in Algeria and Libya to boost your revenues by?

Dr. Ghabbour: As I mentioned, if we sell 1000 cars per month from day one, we're talking about a much higher -- (audio interrupted)

Operator: Ladies and gentlemen, I do apologize. Due to technical difficulties, we will not be able to proceed this conference call. I've been advised that regarding any questions, you can contact the Investor Relations department for any follow-ups regarding this conference call. This conference call has now been concluded and I wish you all a very nice day. Thank you for your patience.

END OF CONFERENCE