Conference Transcription

Date of conference	**:**	**14 August 2013**
Conference title	**:**	**Ghabbour Auto – GB Auto 2Q13 Results Presentation**

CONFERENCE DETAILS

Conference Date:	14 August 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 Second Quarter 2013 Results Presentation Conference Call. From Ghabbour Auto we have Dr. Raouf Ghabbour, CEO; and Mr. Mustafa Al Mahdi, CFO presenting the second 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.

Raouf Ghabbour: Thank you, Mark. Good afternoon, ladies and gentlemen and thank you for joining our Second Quarter 2013 Earnings Call. We are dialing into this call now while Egypt is facing a very challenging state. Like everyone else is Egypt, we have no way of knowing how the fast the situation will resolve itself, nor can we provide guidance on any potential short-term consequences. What I can assure you is that as was the case on January 2011, we have implemented a plan to secure our workforce, our facilities and our own distribution network; and at the same time, I'd like to reassure you all that we see today's items as a short-term cycle.

We are no less optimistic about our nation's future today than we were yesterday, last week or last month. Therefore, I won't say we are cautiously optimistic, because I think cycle performance you've seen in the first half of this year is representative of the new normal for our business; great highs when we have political and economic stability as we had in the first quarter, and significant challenges when the winds blow in the opposite direction. This resembles nothing so much as a boxing match, where despite taking several one-off blows, we have proven up to the challenge and not only defended ourselves, but also came up with new tactics to hit back with more strength than ever.

In the second quarter, GB Auto absorbed hits across markets and key revenue centers. Despite this, we continued to move forward. A few short years ago, a quarter like this would have left us like a boxer facing a standing 10-count. Instead, we have barely missed a beat. Why? Because of our consistent efforts over the past three years to diversify our business by brand and geography; at home and abroad we have continued to invest in growth despite the revolution of 2011, the economic downturn that followed, and the second revolution this past June.

As I imagine you've read our earnings news letters, we faced difficult headwinds in the second quarter. The Egyptian pound plunged in value against our key currencies, prior to its partial recovery following the 30th of June revolution; at the same time, the Korean won remains strong against the U.S. dollar, even as the Japanese yen slipped, making our key competitors' products more affordable. This came as the now previous government doubled custom duties on tuk-tuks to 20%, while our Iraqi operations have returned to historical margin levels due to regulatory changes. What saved us was diversity.

Consumer sentiment may have been at rock bottom in Egypt, but GB serves to a 10% market share in June from next to nothing last year, a remarkable achievement in any market, let alone one as bad as the second quarter.

At the same time, Motorcycle sales continued to surge, which helped offset challenges in three-wheelers in terms of unit sales, but put more pressure on the division's margin.

And we saw our Financing business continue its outstanding performance, while the Commercial Vehicles segment was pleasantly stable. We also saw strong performances from our Tires and After-Sales divisions; both relatively small contributors to the top line currently, but strong contributors to our profitability. Those divisions constitute our breakout during our fierce round of business.

Ladies and gentlemen, many other businesses of our size, particularly in Egypt, battened down the hatches and tried to ride out the storm of the last two years. GB Auto did completely the opposite. We aimed for growth and we will continue to do so in the final half of this year.

Since the 2011 revolution, we have completed our investment in our new robotic paint shop, finished the installation of our state-the-art conveyer system in Prima and moved ahead with the expansion of our Sadat City plant. We have launched a new CKD product and have others in the pipeline. In those two and a half years, we have launched 10 new representations from GD automobiles to Great Wall pick-up trucks and Westlake Tires and Iveco bus chasses.

We have also inaugurated two new after-market sales centers, invested in our own distribution network and aggressively redefined our relationship with our dealer and sub-dealer networks. We have taken a commanding lead in the Tire market and launched our new Financing business right; you can expect the same pattern to continue for the rest of this year and into the next.

After years of patient investment and hard work, we have finalized our products lineup at GB Polo, a development that will help us completely transform the face of our commercial vehicle line of business. Our bus offering has already met with considerable success in new export markets in East Africa, with a 700-unit export contract. What's more we see similarly encouraging signs from ECC-based importers, and GB Polo's importance to the division will be further underscored by our upcoming introduction of a potentially game-changing microbus product.

Yes, growth in Egypt will be slow; the Commercial Vehicle segment rises and falls with the (INAUDIBLE) economy. In the meantime, export-led growth will be the order of the day, alongside catering to base-level demands in Egypt for heavier product and I'm reading before year's end, of our outstanding new microbus.

Second, we made our first sales in the promising new Libyan and Algerian markets at the beginning of last month. The full launch of commercial operations has come a few weeks later than planned, but we are very optimistic in our outlook for both territories given early market reactions.

Last but not least, our new Geely representation has gained a strategic foothold in the Egyptian market, vaulting from zero to 5.5% market share in the first half, and 10% in the month of June. I'm very pleased to report that consumers have quickly accepted Geely as a brand and look forward to continued strong prospects for both Geely and our Hyundai representation. Our goal is to deliver similar results both Libya and Algeria in the periods ahead.

At the top-line levels, I expect to see contributions from Algeria and Libya in Q3 2013, with even stronger performances in the coming year. And I believe this quarter's margins in Iraq represent the new normal for that business.

In Egypt, I remain entirely optimistic in the long term, but rather more cautious in the short term. The performance of our Egyptian businesses will be linked almost entirely to the political and macroeconomic developments. We expect cost-consciousness on the part of consumers and corporations alike to continue to be part of the landscape for the coming half. But we also know that Egyptian consumers are fundamentally resilient. Look no further than the temporary collapse of the tuk-tuk market, following the doubling of customs in the run-up to the June revolution. And as I speak, we are seeing near normal run rates.

As our performance since January 2011 has underscored, we have the people, the products and the systems we need to outperform our peer group locally and regionally, no matter the challenges we face. We will continue to push growth in Egypt and across the region and we will continue to lay the ground work for an even more robust 2014.

With that, I will hand the call over to Mustafa Al Mahdi, our CFO, for a quick look at our financial performance in the second quarter. We will then open the floor to your questions. Thank you. Mustafa, please-?

Mustafa Al Mahdi: Thank you, Dr. Raouf. Ladies and gentlemen, GB Auto revenue in the first half of 2013 was up by 9.2% at LE 4,249.7 million; compared to LE 3,890.2 million in the first half of 2012 as strong first quarter performances in key lines of our business offset second quarter difficulties.

Consolidated gross profit was LE 577.9 million in first half of 2013, a 29.6% increase over the LE 446.0 million in the first half of 2012. Gross profit margin was up 2.1 percentage points in the half year at 13.6%.

EBIT was LE 302.3 million in the first half, a 17.5% increase over LE 257.6 million in the same period of the last year, while EBIT margin stood at 7.1%.

Net income was LE 63.4 million in the first half of 2013, a decline of 17.1% from LE 76.5 million in the first half for 2012. Net profit margin was down 0.5 percentage point at 1.5%.

These results were similarly supported by a very strong first quarter sales and operating profit, while the second quarter saw weaker performance as a result of regulative change in Iraq and a doubling of the customs duties on the tuk-tuk in Egypt.

Despite this, GB Auto improved its cash flow position in the second quarter of 2013, compared to the first quarter of the year. We generated strong funds from operations in the amount of LE 393 million, as we focused on reducing inventories and receivable balances.

We continue to carefully build our Verna CKD inventory, the rate at which this inventory grows will slow as we reach our target values. At the same time, we have successfully reduced the CBU levels with Days of Inventory on Hand, falling to the three-month level for more than 100 days last quarter.

At the same time, we continue to improvement our cash collection cycle, trades receivables have fallen 22% to reach LE 752 million at the end of Q2 2013, compared to the previous quarter. We expect further improvements in our cycle by the end of the third quarter, as we see most of the Iraqi receivables collected.

While the cash flow situation improved in the past three months, we saw a total debt continue to raise, reaching LE 2.9 billion at the end of June 2013, to finance our expansions. This partially explains the increase of the interest expense during the first half of 2013 compared to the first half of 2012.

Net debt to Equity stood at 0.79 at the end of the first half of 2013, while EBITDA interest coverage weakened slightly to 2.6.

We've seen increased pressure on profitability as a temporary effect resulting from the fact that we are currently supporting new geographical markets and consumer focused concepts. These have resulted in a significant increase in SG&A during the first half of 2013, with no matching increase in the revenues. This will change in the months ahead, as Libya and Algeria become revenue-generating and as our new customer-centric philosophy takes hold.

Overall, the first half of 2013 saw our business face significant challenges, especially with the weakening of the Egyptian pound. As we have explained in the previous early news letter, our strategy is to pass most of the resulting price increases to end-customers, in line with market and industry practices. But still we absorbed approximately LE 24 million in Forex loss in the first half of 2013, and expect the operating environment in our key markets to remain tricky in the short term.

The region expansion of our operation to the addition of Libya and Algeria we'll begin to reduce our project invest, concentrating as they begin contributing revenues and cash flow in the present quarter.

That concludes our presentation for today. Ladies and gentlemen, we will now be pleased to take any question you may have. Thank you.

Operator: Thank you. If any of the participants would like to ask a question, you may now press the star followed by the one on your telephone. And if you wish to cancel the request, please press the star followed by the two. Your questions will be polled in the order they are received and there will be a short pause whilst participants register for a question.

Once again, if any of the participants would like to ask a question, you may now press the star followed by the one on your telephone. And if you wish to cancel the request, please press the star followed by the two.

Thank you and the first question comes from Tarek from Investec Asset Management. Please go ahead.

Tarek Shahin: Could you explain in a bit more detail the regulatory change in Iraq and why you think it will lead to as you described as a new normal, for margins?

Raouf Ghabbour: As a matter of fact, Tarek; first of all, good afternoon. As a matter of fact, there was an exemption of the plate fees for two companies in Iraq, two governmental companies; one owned by the Ministry of Industry and another one owned by the Ministry of Trade. And those exemptions were cancelled by the end of March 2013. As a matter of fact, the plate fees are about $5,000 there at least and you can imagine cars selling for $15,000 enjoying a $5,000 discount; this was enabling us to sell at very high margins to those companies and those sales were actually enhancing tremendously our gross margin.

After the cancellation of this, after the waiver of this exemption, we go back to exactly the same level of gross margin which was until the first half or the first quarter of 2012 which is my estimation about 7% to 8%.

Tarek Shahin: Okay. Do you have any similar discounts in Egypt- your margins are higher on CBUs.

Raouf Ghabbour: No. In Egypt, there is no such waiver but as a matter of fact what we faced during the devaluation period was that especially for CBU cars, our margins suffered tremendously and our volumes as well suffered. But I think that going forward; the impact of the devaluation is now behind us. So volumes might still suffer slightly compared to the previous periods, but the margins will go back to normal.

Tarek Shahin: Okay. Thank you very much.

Raouf Ghabbour: Thank you, Tarek.

Operator: Thank you. If anybody else would like to ask a question, you may now press the star followed by the one on your telephone and if you wish to cancel the request, please press the star followed by the two.

Thank you and the next question comes from Alia from CI Capital. Please go ahead.

Alia El Mehelmy: Thank you. Actually I have a couple of questions. Firstly, are you generating margins on GB sales in Egypt and if so can you quantify?

Raouf Ghabbour: Yes, of course we are generating margins. Currently it's 10% to 11%, but we expect after the penetration, the margin will be appropriate.

Alia El Mehelmy: Okay, so you think maybe closer to 12% is a sustainable margin?

Raouf Ghabbour: Yes, I think it's-- no. This is a reduced margin because it's a penetration period and we are expecting from 2014 to go to higher margins. I would say 12% to 14%.

Alia El Mehelmy: Okay. And then my second question; can you quantify the overdue receivables in Iraq and just explain to me if this is a recurring issue or not.

Raouf Ghabbour: The receivables in Iraq were mainly due to the factor I was discussing with Tarek earlier on. When we knew that the 31st of March was the last date to deliver cars to them to have (INAUDIBLE) in those companies, we actually shipped a huge volume of cars that resulted in U.S. $85 million receivables at that time.

As we speak today, the receivables went down to U.S. $5 million. So we have collected $80 million and I expect the $5 million will be collected within this quarter.

Alia El Mehelmy: Okay, perfect. And my last question is I'm aware that you have until the end of this year to purchase what's left of CKD from Hyundai. Are you on track with basically importing the balance of what's left?

Raouf Ghabbour: Yes, as a matter of fact, we have in hand stocks which can carry us forward until the end of next year. But as well, we are currently in discussion with Hyundai Motor Company to extend the supply of CKD until the end of 2015 or maybe end of 2016. And I hope I'll be able to give you good news in the next conference call.

Alia El Mehelmy: Okay, but just to confirm I understand you correctly, the extension allows you to buy what's left of your contract over a longer period of time; is that correct?

Raouf Ghabbour: No. The supply currently is until the end of this year, but as a matter of fact, we have succeeded to build stock which will enable us to continue producing and supply to the local markets in Egypt until the end of December 2014. But in the meantime, we are very hopeful that within the current negotiations we have Hyundai Motor, we think that we may be able to extend to end of 2015 or maybe 2016.

Alia El Mehelmy: Perfect. Okay, and obviously it's difficult for you at this state to quantify how many units that would be-?

Raouf Ghabbour: It will be-- that's according to the market demand. We will be supplying and Hyundai motor will be supplying according to the market demand, provided they give us this extension.

Alia El Mehelmy: Okay, got it. Thank you very much.

Raouf Ghabbour: Thank you.

Operator: Thank you and currently the last question comes from Yousif from UBS Investments. Please go ahead.

Yousif Banayoti: Hello, Dr. Ghabbour. It's Yousif from London calling from UBS with my colleague Peter from the Investment Bank. And basically, we want first to congratulate you for speaking to your always strong, positive conviction about a good future for business in Egypt. You're definitely one of the most courageous people who weathered this situation in the last two years very intact. It's a very simple and very quick question. Do you guys have any plans of expansion of any kind and do you have--did you put provisions for that or-? I mean it's an open question. Obviously, these are very sensitive questions. But it's just- are you looking to expand sometime this year?

Raouf Ghabbour: We are always looking to expand, Yousif. And we are always-- we have the appetite for a good investment opportunity and we may have something to announce hopefully within this year.

Yousif Banayoti: Excellent, excellent; thanks, Raouf. Apart from that, thank you very much and I wish you a fantastic second half of the year.

Raouf Ghabbour: Thank you. Thank you, Yousif.

Operator: Thank you. There seem to be no further questions at the present time. Please go ahead with any closing remarks you may have.

Raouf Ghabbour: Mark, I thank you and thank everybody who has joined our call today and pray for Egypt. This is what I can say. Thank you so much.

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

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