Conference Transcription

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CONFERENCE DETAILS

Conference Date:	6 March 2014
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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 fourth quarter and full-year 2013 results presentation conference call. From GB Auto, we have Dr. Raouf Ghabbour, CEO, and Mr. Mostafa El Mahdi, CFO, presenting fourth quarter and full-year 2013 results.

I will hand over to Dr. Ghabbour for his presentation and then we will have a Q&A session. Dr. Ghabbour?

Raouf Ghabbour: Thank you. Good afternoon, ladies and gentlemen, and thank you for joining our fourth quarter 2013 earnings call. I have three points I'd like to cover this afternoon.

First, I'll take a brief look at the factors behind our performance last year. Second, I'd like to discuss in some detail how we are absorbing the government's temporary ban on motorcycle and three-wheeler imports. And, finally, I'll give you a sense of our outlook for 2014 and 2015.

To start with, I have been running GB Auto for almost four decades and I can say truthfully that the year just ended was one of the worst I have ever seen. As bad as it was, we coped with it. In fact, we thrived in many ways.

We leveraged our experience in challenging markets to drive the best results out of Egypt and Iraq as we simultaneously entered Libya and Algeria. Just six months after introducing it, we captured a 10% market share in Egypt for Geely cars, a brand that was completely unknown at the time we introduced it to the market.

We grew Drive, our consumer finance business to breakeven, while continuing to achieve impressive profitability levels from all of our other financing businesses. We laid the groundwork for a sustainable recovery in commercial vehicles and construction equipment. We rounded out our product portfolio. We added new representations. And we prepared to decisively enter the lubricants, retail, and pre-owned car segments in Egypt and eventually in expansion markets.

We managed this because we have the people, systems, and brands we need, to grow today and tomorrow, when less-confident companies would have long ago fled.

Our passenger car division was impacted in Egypt, first, by large drop in consumer confidence in the lead-up to 30th of June and in the months afterward by continued unrest and then the imposition of a curfew that eliminated traditional shopping hours. What's more, the curfew also significantly impacted our supply chain, while in Iraq the business faced logistics and political headwinds and negative regulatory decisions.

In Egypt, however, I must say that multiple factors played into our loss of Hyundai passenger car market share last year. These include the new price competitiveness of Japanese brands, the implementation of the EU/Egypt Association Agreement and, unfortunately, our attempt to restructure the wholesale market of Hyundai vehicles by dealing directly with sub-dealers.

Our decision to purposefully withhold vehicles from the marketplace cost us market share early in the year that we began winning back in September 2013. Now, as Geely continues to gain ground, we look forward to a record combined market share in Egypt this year.

In commercial vehicles and construction equipment, we saw GB Polo successfully penetrate Sub-Saharan and Middle Eastern export markets in 2013. We also look forward to capturing market share on the back of our new product launches in the 7-seater minivan.

What's more, I'm very confident that we will win our fair share of the government spending on infrastructure projects, starting with renewal of municipal public transport fleet. Corporate fleet spending is still unlikely to be significant before the completion of the presidential and parliamentary elections but government-backed stimulus spending will see this critical line of business do better this year and even better in 2015.

I'm obviously very pleased with the performance of our financing businesses in the past year, where we saw Drive outpace its budget and other units continue to outperform. The growth of GB Capital in the past three years is absolutely proof of GB Auto's ability to launch new business lines and then grow rapidly.

On the tires front, we continue to post strong sales and I am very thrilled about our new addition of Goodyear tire representation to our lineup in Algeria. We expect new supplies of Lassa tires to come on stream and see strong market appetite for our other brands. Tires will continue to be a driver of growth in 2014 and 2015.

Now in Egypt, the motorcycles and three-wheelers line of business experienced muted growth in 2013 on the back of doubling the customs usage early in the year and then the logistical challenges we saw after the 30th of June. The recent regulatory decisions by the government of Egypt to temporarily ban the import of two- and three-wheelers in 2014 will have an impact on our originally-anticipated top line sales. That said, it will have a minimal impact on our bottom line this year. Existing stocks will support a few months of sales and the division continues to enjoy strong pricing power. The ban has done absolutely nothing to curb demand for the product.

The challenges faced by this line of business may also impact growth of microfinance venture, Mashroey, our microfinance business. To somewhat alleviate this potential impact we will actively funnel a higher proportion of unit sales to Mashroey.

In the long term, we are obviously interested in seeing this ban overturned. The prohibition on three-wheelers, in particular, is bad for the economy and worse for development of rural and peri-urban areas. These are areas I note in which the tuk-tuk is often the only accessible means of quasi-public transportation. Moreover, independent analysts believe that three-wheelers create almost 150,000, or more, jobs every year. These are jobs that won't be created this year and jobs that will be lost, as units now on the streets go out of service because of a lack of spare parts.

Going forward, I’m confident that new business lines, new geographies, and new representations will help us de-risk any exposure to single product line or a single country proceed. The addition of Goodyear tires in Algeria will provide a boost, starting this year. Our strategic alliance with Gazprom Neft-Lubricants in Egypt and potentially other markets will also help, particularly starting 2015. We will roll out our new retail concept across the country where we’ll sell and service tires and associated spare parts. Our goal isn’t just to increase revenues but to deepen our relationship with existing passenger-car customers.

I’m particularly excited about the long-term prospects of our new pre-owned vehicle business, which will launch late this month. This marks our entry in a highly-fragmented market with no dominant corporate player. It is also a market that is many times larger than the market for new vehicles.

And, finally, we look forward to rising contributions from our expansion markets of Libya and Algeria. Ongoing sales from these markets will not be significant contributions to our income statement until later in 2014, as we roll out product roadmaps for both markets.

In terms of a specific outlook, I believe that strong Q4 2013 sales could represent the first signs of return to growth-based economic growth. ‘Could’ is the key word. The past three years have proven how much political developments affect consumer confidence. We have also seen how governments can rapidly change regulations when they are cash-strapped and/or facing political challenges.

Broadly speaking, we believe growth in the 15% to 20% range is possible in Egyptian passenger-car sales this year. Market performance in early 2014 has so far reinforced our outlook.

As the overall market returns to growth, unit sales of CBO vehicles will also begin to stabilize. Still, we expect CKD models, including the Verna and Emgrand 7, to be our heroes of 2014. This is why we are actively seeking additional CKD models to add to our product lineup, imminently.

While I expect to see strong growth from Iraq in the medium and long term, short-term growth could be affected by a fluid security situation and a blurry political outlook. It is, I note, and election year. With an emphasis on delivering strong growth in new unit sales in 2014, we may accept erosion of margins as the price of capturing new market share and insulating the country against illegal parallel imports.

I believe that the commercial vehicles and construction equipment line of business is likely to continue its momentum with real progress beginning to show this year and, in particular, in 2015. Drivers here, as I have said, include our new product launches, rising export sales, and government stimulus spending on infrastructure projects.

We expect to see the tires and financing businesses continue growing in the period ahead, as I have discussed.

Meanwhile, we have continued to invest in staff and staff training initiatives that will directly add to our top and bottom lines in the medium term. It is important to note here that while we are continuing to do so, we are keeping a sharp eye on costs and we are aggressively managing our SG&A spending this year. We are determined to rationalize our costs.

It is true that we have seen an uptick in our SG&A in 2013 as a result of investing in new people, new markets, new representations, and new lines of business. However, with healthier sales in 2014 and with our growth initiatives, we expect to see a real improvement in our operational costs as a percentage of sales going forward.

From Iraq to Egypt and beyond, 2013 was tough, as business has been since the dawn of the Arab Spring in January 2011. I'm confident, however, that in the not-terribly-distant future, we will look back on the past three years as a period in which we invested in our futures where others pulled back.

With that, I will hand the call over to Mostafa El Mahdi, our CFO, for a quick look at our financial performance in the fourth quarter and then we'll open the floor to your questions. Thank you very much. Mostafa, please?

Mostafa El Mahdi: Thank you, Dr. Raouf. Ladies and gentlemen, 2013 was a very challenging year, particularly on operations environment and working capital management fronts. While we began the year with a very strong sales and operating profits in the first quarter, the second and third quarter were two of the toughest we have seen in the post-revolutionary period. The final quarter, however, exceeds our expectation in terms of recovery we have seen on all fronts.

In the full year, GB Auto recorded 10.1% growth in the top line and 9.4% growth in gross profit. Our decisions to continue to invest in the businesses and our people, while proceeding with our planned expansions led to natural increase in the Company's SG&A. We expect SG&A as a percentage of our turnover to decline as our new businesses begin contributing to the top line and as we continue with our aggressive cost rationalization strategies. But as Dr. Raouf has said, we absolutely see that as a mandatory investment for long-term growth and we are confident that we contain this cost, going forward.

Alongside increased costs, the bottom line was impacted by interest expenses incurred as a result of working capital needs, mainly due to the build-up of our inventory of our CKD kits. Total group debt accordingly increased to EGP3.3 billion at year end 2013 from EGP2.5 billion at December 31, 2012, leading to a 24% increase in our interest expenses to reach EGP379 million. This resulted in a slightly weaker EBITDA interest coverage at 2.1 times compared with 2.5 times in 2012.

Having said that, GB Auto closed the year with a working capital cycle back to the levels of 2012 and significantly down from the first three quarters of 2013, with further improvement to show in the first quarter 2014 figures and going forward in the same year as a result of a natural decrease of CKD stocks as we start deploying the inventory build-up in 2013.

Our receivables reached EGP875 million at year end, up from EGP781 million in 2012 with an increase driven mainly by the growth in our financing businesses. Due to the inventory built up during the year, as well as the interest incurred the Group run a net operational cash outflow of about EGP200 million, a trend we are expecting to reserve during this year.

While we continue to look to our long-term growth prospects in existing markets, we have maintained an aggressive pace of investment in future expansions leading to a pressure on our cash flow that is a natural for expanding businesses. We expect that the payoff of these new business and investment will more than compensate for our increased costs. Management fully expects better capital utilization and return ratios as this evolves.

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

Operator: Thank you, sir. If any participant would like to ask a question, please press the * followed by the 1 on your telephone. If you wish to cancel this request, please press the * followed by the 2. Your questions will be rolled in the order they are received. Once again, if you'd like to ask a question, please press the * followed by the 1 on your telephone.

The first question comes from Ahmed Hafez from HC. Please go ahead.

Ahmed Hafez: Yes, hi. First of all I want to thank you for the call. I just have a couple of questions that are related to the financing business.

What I want to understand more is the reporting of the business in terms of revenue recognition. I mean is this business being run as a typical financing business where what you're recording on the revenue is interest income? Or is it more like selling on installments and what actually you're recognizing revenue is the value of the unit sold and then you have receivables on the balance sheet that are being discounted to present value and, as you collect the installments you charge some of this interest on the income statement? This is number one.

Also, I mean these types of businesses are usually leveraged so if you can just give us an idea about the equity and the debt contribution for this business as we stand today and if you plan to increase this going forward to whatever leverage you think is appropriate to sustain the growth in the business.

And finally, also, regarding the CAPEX spending, if you can also give us some sort of a breakdown between how much of this is related the lease business that you have there. Because I mean the CAPEX figure on the cash flow statement for the year is around EGP800 million. So if you can just give us a little more details on this.

Raouf Ghabbour: Mostafa?

Mostafa El Mahdi: Thank you very much for the question. Regarding the first one, of the revenue recognition policies; the revenue recognition policies are typically driven by the type of business we are in. For the business, it's a combination of the installment recognition policy for the sales that is showing up in the installment basis and for an interest on the other finance business.

Ahmed Hafez: The other two businesses are --

Mostafa El Mahdi: Are pure financing business. Taking into consideration this combination, for the second question about the debt level; as you know the level of debt for a financing business is different from the level accepted for other businesses and, according to the guidelines by the Central Bank of Egypt, the level of debt accepted for a financing business is 8 to 1. However, over the combined financing business we are not reaching even 3 to 1, maybe less than 30%.

Regarding the asset base, rightly you said a very significant part of the growth of the CAPRX is relating to the increase of the base of the financing business as long as the Egyptian accounting standards apply for leasing business does not accept the transfer of the leased assets from the books of the lessor to the lessee. This has been shown as a CAPEX on our consolidated financial statements.

Raouf Ghabbour: So as a matter of fact, the paid capital in the three finance businesses is about EGP160 million, while the combined debt of the three businesses is at EGP668 million.

Ahmed Hafez: Okay. Okay, thank you. Thank you very much.

Raouf Ghabbour: Thank you.

Operator: Thank you. The next question comes from Binay Singh from Morgan Stanley. Please go ahead.

Binay Singh: Hello, sir. Thanks a lot for this opportunity. My question was basically on trying to understand the three-wheeler and two-wheeler ban in Egypt. First, could you talk a little bit about why is this ban implemented? What is the rationale behind it?

Secondly, in terms of implementation, how do handle inventory that is sitting at your end?

And, lastly, there are conflicting media reports on whether it’s a three-month ban or one-year ban. So could you clarify on that?

Raouf Ghabbour: I didn’t get the second question.

Binay Singh: The second question is that; whatever inventory that is sitting at your end, how does the implementation work? Like did you stop selling it that day it got implemented or you actually got an opportunity to clear the inventory?

Raouf Ghabbour: Okay. Basically, the rationale behind the ban is most of the three-wheelers and a big part of the two-wheelers operating in the country are not registered or not licensed so they don’t have plates. And, accordingly, during the few weeks before the ban, a lot of terrorist attacks happened using motorcycles and shooting police officers and soldiers randomly in the streets.

So, my understanding, and I have got the same feedback from the Ministry of Interior of Egypt, the objective of having the ban, the government's objective from the ban, is to put in place an mechanism through which they would guarantee licensing the existing fleet in the country and putting a mechanism ensuring that no single new imported two- or three-wheeler will be delivered to the end user without a mechanism guaranteeing its licensing. So the objective is not the ban as much as regulating the current fleet and guaranteeing the regulation of the new imports after the cancellation of the ban.

The second question.

Raouf Ghabbour: The inventory, as a matter of fact, any existing inventory or any letters of credit opened before the date of the ban has absolutely no restriction to be customs cleared or sold to the customers. So, as a matter of fact, you could understand from what I said that the impact on the bottom line this year is going to be very minimal. Is that, as a matter of fact, we immediately increased the selling prices of the three-wheelers and motorcycles so our margins will be compensating 90%, I would say, of the margin or of the bottom line. Our margin on the current stock will compensate the majority or almost 90% of the bottom line, which we were projecting for this year.

The third question?

Binay Singh: With regard to the ban, what does it state exactly?

Raouf Ghabbour: The ban is actually for one year. It is three months for manufacturers. And we are not actually manufacturers. We are importers. So, the ban applied on our activity in two- and three-wheeler is actually one year.

But definitely, we will be lobbying with the government trying to reduce that or overcome that. And we will do this through providing them with solutions to guarantee that any new motorcycle or three-wheeler imported in the country will be licensed. I have a mechanism in mind, which I'm going to start discussing with them.

What delayed the process was the fact that the government was changed so we didn't have time to start the lobbying. And then the new government in place has been for a week now and, of course, they are too busy. And we will shortly start having negotiations about it.

Binay Singh: And just with regard to your second point, when you mentioned that the impact of profitability will be limited, so there are two angles to it. One is volume then the other is margin. So, in terms of volume, how do you see volumes playing out for you in 2014 versus 2013?

Raouf Ghabbour: I don't recall exactly the volume but -- I can tell you. We were planning 72,000 three-wheeler. We will be achieving, assuming that the ban is lasting until year end, we will be achieving 27,000 down from 72,000. But the profitability per unit of the 27,000 is going to be almost three times the profitability before the ban.

Binay Singh: Okay, okay. That's very helpful. Thank you so much. That's actually helpful. Thanks a lot.

Raouf Ghabbour: Thank you.

Operator: Thank you. As a reminder, if you'd like to ask a question, please press the * followed by the 1 on your telephone. We have a follow-up question for Ahmed Hafez from HC. Please go ahead.

Ahmed Hafez: Yes, hi. Sorry. I just have a quick follow-up on the financing business. I was wondering if you can, maybe going forward in the disclosures, add some sort of number of units that this business is involved in or any sort of details that would helpful for us in order to see how it can grow going forward? Because, as it stands now, it's just a single line being reported. I mean with the potential there, I think it's quite important to have a better understanding of the prospects of it.

Raouf Ghabbour: I think it is possible for the consumer finance and for the microfinance. It may be a bit difficult for the financial leasing. And I will try to help you now, at 90% accuracy.

I think that 2013 fiscal year, consumer finance delivered 2,000 passenger cars; total volume was about 2,000 passenger cars. The microfinance was about 15,000 three-wheeler and something like 6,000 or 7,000 two-wheelers. Plus, they do some other activities, which we'll not be able to report. They are getting into the animal feed soon. So, we'll try to clear it out. Regarding GB Lease, GB Lease's financing, I think the automotive part of the business they are financing is almost 35%. Automotive is 35% and the majority is real estate or medical equipment and other projects. So we definitely will try to put some more clarity on our reporting.

Ahmed Hafez: Okay. Thank you very much. That was extremely helpful. Thank you.

Raouf Ghabbour: Thank you.

Operator: Thank you. The next question comes from Samir Murad from NBK Capital. Please go ahead.

Samir Murad: Hello. Good evening, gentlemen.

Raouf Ghabbour: Good evening.

Samir Murad: I have a question relating to the pre-owned vehicles that you said you will be starting soon. Can you tell us a little bit more about this business? How do you plan to go about it? How will you be getting the inventory for it? Will it be sourced locally or will you be importing the cars?

Raouf Ghabbour: As a matter of fact, import of used cars is prohibited in Egypt.

Samir Murad: Okay.

Raouf Ghabbour: So, basically, the fact that GB Auto is the only corporate which has tapped into this activity makes this very easy for us to source because all competitors, I mean other brands, are extremely open to give us the used cars they are receiving form their customers against a trade-in. And in the meantime, GB Auto, which is controlling almost one-third of the total market, we are in control of our fleet so we will be supplying, I would say, almost one-third of the requirement.

As a matter of fact, the Egyptian citizen who wants to sell his used car currently doesn't have a professional service giving him the comfort that he is getting the best price for his used car. We are stepping in, providing all the related services, which will make the customer extremely happy and attracted to use our channel for this type of business.

What we are offering the customer, we are actually, and for the first time in the country, we are buying the cars at very attractive prices. We are the distributors of HBC, which is the smart repair company from Denmark. And we are doing smart repairs; any damage or any slight paint repair or repair on the headlights or the windshields or repairs on the upholstery or the dashboard of the car is being conducted at very competitive cost. And we are reselling the car, giving it a very short-term extended warranty.

While buying the car from the seller, we are offering him to sell him a new car from our product range and we are offering him financing through our consumer finance company for the balance required. And while selling the used car, we are again offering finance for the buyer of the used car. And through all those options, we expect that this is going to be an offering which is going to be extremely well received by the customers.

Of course, we are going to be using internet, our website, advertising in the different media channels, as well as pre-existing retail network, which is also the country either our own showrooms or our own workshops as well as our dealer retail network and dealer after-sales network.

So we have almost 100 selling points through which we will be keeping our customers aware and attracting them to sell their used car. And sometimes, even he doesn't have the idea of replacing his car with a new one, we'd be selling the idea to him and triggering it in his mind.

Samir Murad: Okay, thank you. That's very helpful.

Raouf Ghabbour: Thank you.

Samir Murad: A second question, if I may, looking at how Geely has been performing in the second half of this year, it has been doing quite great. The market share is quite impressive at 10%. You're almost selling, for every one Verna, almost one Geely car, at the moment. Okay. But in the presentation you mentioned that you might be looking at other options for CKD. Is it an indication from your side that the Geely cannot replace all the demand on Verna or is it that you're just seeing a lot of consumer appetite for such CKD products as you are just looking for other products in that category?

Raouf Ghabbour: No. What I really meant was, not adding other brands, but was adding new CKD models from both Hyundai and Geely. We think that there could be another model for Geely in the next few months or, latest, by the beginning of next year which will give Geely a product portfolio attacking, I would say, 80% of the total market demand. And we are also in discussions with Hyundai Motor for a new model to be assembled in our factory. So I wouldn't say that each Geely car selling against each Hyundai car. Geely is at 10% market share while Hyundai is at 22% market share.

Samir Murad: No, I was looking at the Verna in specific, Dr. Ghabbour.

Raouf Ghabbour: Even for the Verna, I think that our run rate for Verna now is almost at 2,000 cars a month while it is 1,200 for Geely. So it's almost half. But we think that the two brands are extremely well accepted in the market and what we are planning to do is adding new models from both.

Samir Murad: Okay. So what I can understand from you that Hyundai has now relaxed their position a little bit against sending you -- because in previous calls you said that Hyundai doesn't want to do CKD business. So have they changed their mind, you feel, on this topic?

Raouf Ghabbour: I think they are changing gradually. Their latest position is; we will be open to discuss new models CKD after the completion of the political roadmap of Egypt. So they want to see that. We already saw the constitution referendum and they want to see the presidential election and the parliamentary election and then they will be open to discuss new products in CKD. So, in principle, they agree to extend the CKD in case the political situation stabilizes.

Samir Murad: Okay. Okay, thank you.

Operator: Thank you. There appear to be no further questions. Please continue.

Raouf Ghabbour: If there are no further questions, I thank everyone for joining our call today. And I hope that our next conference call will strengthen the feeling of everyone about the improving stability of Egypt and, hopefully, our market as well. Thank you.

Operator: Thank you. This concludes the fourth quarter and full-year 2013 results conference call. Thank you for participating. You may now disconnect.

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