Company: **Ghabbour Auto**

Conference Title: **Second Quarter 2014 Results Presentation**

Moderator: **Dr. Raouf Ghabbour, Mr. Mostafa El Mahdi**

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Operator: Good afternoon, ladies and gentlemen. Thank you for joining our Second Quarter 2014 Results Presentation conference call. From GB Auto, we have Dr. Raouf Ghabbour, CEO, and Mr. Mostafa El Mahdi, CFO presenting second quarter 2014 results. I will now hand over to Dr. Ghabbour for his presentation and then we will have a Q&A session. Please go ahead.

Dr. Raouf Ghabbour: Thank you. Good afternoon, ladies and gentlemen, and thank you for joining our second quarter 2014 earnings call. In today's call, I will be mostly focused on the fruits of our expansion plans and our outlook for future growth.

Looking back, it is clear that the spillover of the great recession into our home market has protected GB Auto against future turbulence. It was then that we first began articulating the strategy of diversification that has allowed us to continue to grow despite the far greater challenges across our region that have followed the Egyptian revolution of 2011. This diversification drive has seen us expand geographically. We have added new lines of business and new products to existing lines of business, and what you have seen has been stages of rapid change followed by periods of consolidation as we optimise our approach to new markets and segments. For instance, after significant investment in our commercial vehicles manufacturing capacity, we are now seeing the payoff as we win large domestic and export contracts for our bus division. Meanwhile, we invested in both our CKD passenger car production capacity and our bandwidth to market new brands resulting in GB's capture of a 10% market share in its first full year of operation. We penetrated the finance sector and have grown to own subsidiaries that stand today as the second largest corporate finance player in the Egyptian market, GB Lease, one of the fastest-growing – and one of the fastest-growing microfinance ventures, Mashroey, and an exciting factoring finance business, Drive.

Today, as we continue to optimise our approach to new markets in Algeria and Libya as well as new lines of businesses including lubricants, retail and pre-owned vehicles, we are simultaneously laying the groundwork for our next wave of expansion. The expansion could include at least one new geography and a new line of business. It also may see us further diversify within five existing lines of business and we require access to fresh capital. With extensive support from C-suite management, our finance and business development departments have finalised the strategy to roll out and finance our growth plan. We look forward to presenting this to our Board of Directors in the near term, after which we expect to invite shareholders to consider approval of a capital increase via rights issue at par. Our shareholders will gather for that Extraordinary General Meeting knowing that management has worked consistently to grow their business, a fact evidenced in our second quarter 2014 results, which are backed by outstanding sales performances across our lines of business.

Continued foreign exchange expenses due to the weakening of the Egyptian pound have seen our bottom line grow slower than our top line. Moreover, we continue to support new businesses that are still in their earliest phases of development. This is a pattern that we expect will hold through years then until we begin delivering larger revenue contributions from Algeria, Drive, retail and pre-owned vehicles among others. In the passenger car segment, our record performance in the second quarter makes it clear to me that Egypt will continue to grow substantially in the second half on the back of pent-up demand for Hyundai and GB vehicles. Moreover, we expect our fuel-efficient models will be sought after as the government continues to remove fuel subsidies. Drive, our factoring finance business, will deliver a rising proportion of sales and we see the broad horizon for our pre-owned vehicle segment limited only by our ability to source inventory. Our performance in Algeria will pick up in the new year as we bring in new models ideal for this market, and we will serve demand in Libya in a way that minimises our capital exposure there until stability begins to return to the market. We are similarly exposed to on-the-ground developments in Iraq where we have taken steps to minimise risk in the South and we will continue to cater to strong demand in the North, which has historically accounted for the lion's share of our Iraqi sales and which remains our primary logistics hub there.

Meanwhile, I am particularly gratified that the Egyptian Government has allowed its ban on the import of components for motorcycles and three-wheelers to expire and look forward to this division returning to its historical levels of contribution to both the top and bottom lines. We will be particularly watchful here for new opportunities to cater to demand in a manner that satisfies local regulatory requirements and that continues to add value to the domestic economy. On the commercial vehicles and construction equipment front, my optimism on the second half of this year performance rises almost daily as we continue to capture a significant portion of the new demand generated by infrastructure spending and the recovery of consumer sentiment. As the tyres business begins to move past the market oversupply that characterised the first months of this year, we look forward to stronger pricing power and the start of sales of Goodyear tyres in the Algerian market. The financing business will continue to be one of our strongest engines of growth and profitability and I expect the same prudent approach to management will also see us deliver strong results in the new year from our retail and lubricants segment.

With that I will hand the call over to Mostafa El 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 so much. Mostafa please.

Mr. Mostafa El Mahdi: Thank you, Dr. Raouf. Ladies and gentlemen, good afternoon. Perhaps more notable than the 42% year-on-year surge on second quarter revenues in the pack, it looks more important that this growth is across all the core lines of business. Management believes this broad base of growth reflects the acceleration of trends, noted trends late 2013 to improved consumer sentiment, as well as early signs for re-recovery in some sectors of the accounts. While profitability has improved on both second quarter and first half of the year basis compared to the same period last year, bottom line growth continued to be affected by the currency challenges that translated into EGP 69 million in foreign exchange burden for the first half of 2014. Foreign exchange considerations have similarly affected GB Auto's typically strong pricing power in the market as Japanese players have enjoyed new price flexibility in view of the comparative weakness of Japanese yen versus the Korean won.

Our total debt as of June 30 2014 stood at EGP 4.3 billion, up from EGP 3.5 billion at the end of the first quarter on the back of a shareholder loan and the growth of the Group's financing businesses. An Ordinary General Meeting of shareholders held on June 2 2014 approved the Company's acceptance of a shareholder loan including a US dollar portion as well as another portion in Egyptian pounds. The balance of the loan as at June 30 2014 including the interest amounts to EGP 497 million. This loan carried an annual interest rate of 10.5% on the Egyptian portion and compared to our Company's current average borrowing rate at 10.99%, almost 11%. It also carried an annual interest rate of 3.25% per annum on the US dollar portion compared to 4.75% per annum as the current average rate for the US dollar borrowings. The growth of total debt also reflects the strong growth of the financing businesses. Debt related to financing business peaked at EGP 539 million on the balance sheet as of June 30 2014. That raise in our debt still leaves the financing business underleveraged compared to both the market norm and the cap by the regulator in this business, which is 9:1 debt to equity.

Notably, strong sales in the quarter and careful order management have together seen inventory levels fall by almost EGP 251 million to stand at EGP 1.9 billion at the end of 30 June 2014, and which brought days of inventory on hand down to be two months' – this is a sharp improvement from the three months' level last reported at the end of the first quarter 2014. That improvement helps, improving cash flow operation generated EGP 21 million in cash inflow in the second quarter compared with a net cash outflow deficit of EGP 279 million in the first quarter. GB Auto continues to emphasise long-term growth through the expansion of current lines of business, new lines of business and new geographies. As such, management will maintain and aggressively invest – that may result in a cash flow mismatch at the short term that access of new lines of business, and of course that brings the initial cost of growth of both expansion and cash flow mismatch is going – sorry, going forward to a better capitalisation – capital utilisation and substantially improve the returns ratios.

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

Operator: Thank you. If you would like to ask a question please press *1 on your telephone keypad. Please ensure that the mute function is switched off to allow your signal to reach our equipment. Again, please press *1 to ask a question. We will now take our first question from Frances Ames. Please go ahead.

Frances Ames: Hi gentlemen, congratulations on the results. I just have one quick question. I noticed that the growth in the Geely market share seems to have slowed down quarter-on-quarter, so there wasn't a big jump again in how much market share Geely had in Q2 versus Q1. Can you just comment on what your targets are moving towards the end of the year for market share there?

Dr. Raouf Ghabbour: Actually, we are handling only two models from the Geely product range and one of the two models is assembled locally, it's a CKG business, and the other one – which tackles a very narrow market segment – is handled in the form of imported cars. So actually, the performance of Geely is practically 10%, almost 10% of the total market, but it is only with covering two segments of the market out of the total market. So the market share per segment is far bigger than the 10%. We are starting some time next year the assembly of a third model – of a second model – from Geely, so we'll have three models. And that model is catering for the biggest segment of cars in the Egyptian market. So going forward, we expect Geely market share to grow from 10% to above 20%. That's after we start the third model.

Frances Ames: That would be though in 2015-2016, correct?

Dr. Raouf Ghabbour: Yes, right. From the second half of 2015. If we have seen a slowdown in the growth of Geely's market share in the second quarter, it is due to our capacity to supply from the factory. So it is mainly due to either capacity constraints either because of power shortage, which not only GB Auto but the whole market is suffering from, or from shortage of supply. In some months we did not get the volumes we were expecting due to some delay of shipments. But overall, the demand for the car is tremendous.

Frances Ames: Great, and I just have one follow-up question. Can you just comment a little bit further on the pickup so far in the used cars business and what the targets are for rolling out additional showrooms for that business for the rest of this year and next year?

Dr. Raouf Ghabbour: You said used cars? Our challenge in the used car business is basically supply of cars or sourcing of cars. So whatever cars we get, we just immediately sell and at a very good margin, far beyond the margin we were planning in our business plan. We are, we started our soft loans some time in March this year. We started our marketing campaigns, we are educating the market. We are rolling out the service throughout all our retail network as well as through our dealer network. We are making a lot of activities on the internet and in the media, in the different media, and we see the rates going up. Of course, it is a bit – sorry, last month we doubled the volume of the month before but it is a drop in the ocean because at the end of the day, we were selling 10 cars a month; last month we sold 20. I expect this rate to increase gradually the further we roll out the service throughout the network. I have done a very important strategy change which I am confident will bring a big success to this business. That business was separated from the passenger car operations of Egypt. It was separated from the new cars business. A month ago, it was brought under the management of the new cars because I discovered that the new car – or our showroom and our dealers' showrooms are the main source of sourcing for used cars. So as long as it was isolated, it was really struggling. But being under the responsibility of the new cars sales team or distribution team, I expect that lots of synergies would start playing in favour of the used car deals.

Frances Ames: Sure, and that's your solution for the sourcing problem? You're not going to be exploring importing used cars or something like that? It's just you need to just keep – like where are your, what is your expectation on sourcing these cars other than the Hyundai, the cars from the dealers themselves?

Dr. Raouf Ghabbour: No, the cars from the dealers is not Hyundai cars because our dealers are not only selling Hyundai cars; they are selling all cars.

Frances Ames: I see.

Dr. Raouf Ghabbour: So when you roll out the service through the dealer network, you're getting all the time in the market. As well, a customer who is coming to our exclusive Hyundai showroom is in many cases riding a Toyota or a Mitsubishi or a Renault car. So we will be outsourcing other cars. The fact of, the possibility of importing used car is not available in Egypt because importation of used cars is prohibited in this country.

Frances Ames: Sure, that's what I thought. So what this is going to depend on is you guys sourcing domestically increasing volumes of used cars through your dealer network and through your own direct sales network.

Dr. Raouf Ghabbour: And educating the market through marketing campaigns offering our financing facilities either for the owner of the used car to encourage him to sell his used car against buying a new car and pay the balance on instalments through our Drive finance facility, or offering the customer of a used car to buy a used car with an extended warranty with an improved condition after we do some repairs in the body and the paint and the mechanical, and giving him as well payment terms facilities and some kind of service contract with a special discounts or something.

Frances Ames: Sure, thank you.

Dr. Raouf Ghabbour: So it’s an educational process which is taking place.

Frances Ames: Great.

Dr. Raouf Ghabbour: Thank you.

Operator: We will now take our next question from Tamim Elyan. Please go ahead.

Tamim Elyan: Good afternoon, Dr. Raouf, this is Tamim Elyan from Bloomberg. I just wanted to ask about your expansion plans and your financing options for those expansion plans. We know them, you told the market that you are planning a rights issue and you have an expansion plan in process. I know the plan might change after the board meeting but can you give us general headlines about your targets for the capital increase, how much do you target? And what kind of projects or expansions are we going to see?

Dr. Raouf Ghabbour: I'll let Mostafa answer this.

Mr. Mostafa El Mahdi: Good afternoon.

Tamim Elyan: Good afternoon.

Mr. Mostafa El Mahdi: According to the regulation of the Egyptian Stock Exchange, this kind of information cannot be disclosed before we submit to the Stock Exchange a certain form with certain strategy. So this will be announced shortly after the board meeting which is planned to be taking place within a couple of weeks at max, and to approve the plans and then after that, this will be disclosed.

Tamim Elyan: Sorry, it will be disclosed within two weeks?

Dr. Raouf Ghabbour: Now, to put this into in general terms, definitely we have some expansions to do in our manufacturing facilities and we have some expansions to do in our after-sales facilities as well. So basically there are a lot of things, but basically the biggest portion is going to be our manufacturing facilities because currently we are operating at full capacity and we are unable to cater for the full demand of the market.

Tamim Elyan: Okay.

Dr. Raouf Ghabbour: And we think that the demand will grow further.

Tamim Elyan: And you said that you are also studying other financing options. Will you seek other finance, other funding rather than the capital increase…?

Dr. Raouf Ghabbour: No.

Tamim Elyan: i.e. You will seek loans or something?

Dr. Raouf Ghabbour: No, no. No. we don't need to increase our borrowings further but they will increase because of the finance businesses and the growth of the business but we are not willing to seek other options.

Tamim Elyan: So the final question: when do you expect Algeria to contribute to your revenues?

Dr. Raouf Ghabbour: I think that we are starting from September or October receiving new models catering for the exact demand of the Algerian market. So actually, I can see 2015 being the first year where the Algerian venture will start paying off. As well, we have just started or we are starting this month producing the Goodyear tyres. So I consider definitely 2015 is going to be the breakthrough of the Algerian operation.

Tamim Elyan: Thank you. Thank you so much, Dr. Raouf.

Dr. Raouf Ghabbour: Thank you. Thanks.

Operator: We will now take our next question from Samah Dissi. Please go ahead.

Samah Dissi: Hello, thank you for holding the call. I had a question on the two- and three-wheelers. Now given the expiration of the import ban in May, how many units do you expect to sell in the second half of 2014?

Dr. Raouf Ghabbour: As a matter of fact, I started selling very late May, let's say in June I remember I sold about 5500 units. In July, I got out of stock so I sold only 1000 or 1500, which was the stock remaining. I just customs-cleared yesterday the first fresh imports so I'm starting to sell from next week, and I expect a rate of – from August to year end – I would say comfortably five months by 6, which is 30 plus the 1000 of last month is 31.

Samah Dissi: Okay, thank you.

Dr. Raouf Ghabbour: Thank you.

Operator: We will now take our next question from Samir Murad. Please go ahead.

Samir Murad: Hello, good evening, gentlemen. I have a question relating to the foreign exchange losses. I just wanted to know from Mostafa how do you realise this foreign effects loss. What, from an accounting perspective, what happens that leads to this foreign exchange loss being recorded on the income statement?

Mr. Mostafa El Mahdi: Frankly, that's forex relating to – we have two channels to secure our source of funds from foreign currency, okay, and according to the regulation of the tax authority in Egypt, you are required to be doing your booking based on the announced official rate of the foreign currency you are dealing with. And there is a gap which is, it depends on a day-to-day basis which on average over the six months is more than 50 piastres in each dollar, which resulted in this huge – yes, forex burden to the Company's operation. In reality, when the Central Bank starts to reduce the gap between the free market and the official market, we experience a reduction in the hit we get from the forex loss.

Samir Murad: Okay, thank you.

Dr. Raouf Ghabbour: Simply, we have to book based on according to the tax authorities, based on the official rate published by the Central Bank of Egypt base. So that rate today is 7.16 – 7.18. If you are buying a big portion through the black market, which from the foreign exchange dealers, which is at about 7.40, so you have a 32 – a 22 piastres difference. That 22 piastres makes EGP 69 million in the first half.

Samir Murad: Okay.

Dr. Raouf Ghabbour: Yes.

Samir Murad: Okay, so as long as this gap between the black market and the Central Bank remains, you will continue to incur on the income statement this FX loss?

Dr. Raouf Ghabbour: Yes, but unfortunately – or let's say fortunately – during the first six months, the gap was actually about 50 piastres because in the beginning of this year, until three months ago, the official rate was 6.99 and we used to buy at 7.50 or even sometimes at 7.59. So the gap was anywhere between 50-60 piastres to the dollar. During the period of – this was end May – the Central Bank gradually raised the rate from 6.99 to 7.18, while the black market rate went down from 7.55 to 7.38. So today, actually the foreign exchange hit during June and July has been very mild compared to the first five months of the year. So if that trend continues, I expect that the foreign exchange will not be a serious hit to the business during the second half. So basically, I personally think – that's my own theory – I personally think that the Central Bank of Egypt will not devalue the Egyptian pound further within the next few months because during the last months, they reduced the subsidies on fuel and basic items and they do not want politically to let the people feel that the prices are going even higher by the reduction of the value of the Egyptian pound. So I think that we will watch a certain level of stability in the foreign exchange during the next few months.

Samir Murad: Thank you, this is very, very clear. I have another question, Dr. Ghabbour. It doesn't relate to the financials. I have realised that Hyundai, they are talking now about the new 2015 Sonata model and it's coming with a new engine that's 1.6 turbo. Does this turbo engine, would it affect customers in Egypt and would you be acquiring such models?

Dr. Raouf Ghabbour: At the moment, the launch – 1.6l engine Sonata, we'll definitely launch it in Egypt because from 1/1, from 135% custom duty for the existing 2.0l and 2.4l Sonata, you will be clearing at 40% for the 1.6l engine. So it will be very competitive and will be a big success in our market. Definitely we are watching it and as soon as it is available, we'll launch it.

Samir Murad: So the turbo engine doesn't, it doesn't change the way the customs look at it if it's a turbo engine?

Dr. Raouf Ghabbour: They don't care. They care about the engine capacity.

Samir Murad: Okay, great. So this, when this happens, this would be a big positive for you.

Dr. Raouf Ghabbour: Yes, of course.

Samir Murad: Great, thank you.

Dr. Raouf Ghabbour: Thank you.

Operator: As a reminder, if you would like to ask a question please press *1 on your telephone keypad. We will now take our next question from Hadeel Al-Masri. Please go ahead.

Hadeel Al-Masri: Hello and thanks for holding the call. I just wanted to ask very quickly about the Iraqi market. I know the current situation isn't that good and I wanted to know your outlook on the market for the remaining of the year. And have you halted sales in the region or not? And something else very quickly about if you can give me a quick just, a quick update on the Algerian market. Is there potential there? Is it undersupplied? That sort of thing. Thank you.

Dr. Raouf Ghabbour: The Iraqi market is the one million dollar question. I really don't know. Okay, listen, for time being, the market is paralysed. I personally think that we – or out of experience, I have seen the same situation in Egypt after the 25 January 2011 whereby the market during February and March was completely paralysed.

Hadeel Al-Masri: Okay.

Dr. Raouf Ghabbour: But the market still came back, business as usual starting from April. So it took two months for the people to kind of normalise their – go back to their normal life. I think this is what's happening in Iraq now. The people are not thinking about going to the market or making a decision to buy a new car. People are talking politics and people are scared because I think what's happening in Iraq is much more serious than compared to what happened in Egypt in 2011. In 2011, we had a revolution. In Iraq, it's almost a civil war. So it's much more serious. Whether it will take two months, four months or six months to get back things to normal, I don't know. But what I can tell you is that there is demand coming from the government so during last months we saw almost 1500 cars basically to the Ministry of Interior and the Ministry of Defence and some government authorities in the Iraqi market. So the business is not dead but definitely it is very negatively affected. I don't have a crystal ball. I don't know what will happen in the future. I hope we will be able to navigate and survive and I hope it will settle as soon as possible.

Hadeel Al-Masri: Okay.

Dr. Raouf Ghabbour: Back to Algeria, in Algeria the market was booming for the last three years. The Algerian government was giving the young people, the young citizens very huge loans which, to my opinion, it was not loans, it was grants because they usually do not pay those loans. They used to give them loans to buy cars. So the Algerian market grew from about 300,000 vehicle to 550,000 vehicles. End of this year – end of last year, the Algerian government shifted from loans to buy cars to loans to buy flats or real estate. Suddenly the Algerian population forgot about the cars and they are queuing now to collect the money to pay the down payment for getting their flat at almost for free. This has led the Algerian market to drop by 32% in the first half of this year versus last year. So we expect the Algerian government will reduce to something like 350,000 down from 550,000 this year. Everybody had a pipeline built based on the demand historically during 2013 and '12. So currently, the Algerian market is flooded with cars. There is no supply issue. The issue is selling the cars. The issue is in the demand. There is very low demand compared to the volume that's supplied. It is a very difficult situation. Thank God we don't have that big stock but we think it's a very good learning curve for us because we are preparing ourselves, we are finding the tools to convince our suppliers to give us the right prices and the right models for attacking the market leader this year and next. But as I earlier mentioned, our breakthrough is going to be from 2015.

Hadeel Al-Masri: Okay, thank you. Thank you very much.

Dr. Raouf Ghabbour: Thanks.

Operator: We will now take our next question from Frances Ames. Please go ahead.

Frances Ames: Hi, Dr. Raouf, just one follow-up question. I wondered if you could just give an update on the order book for the commercial vehicles. My memory is that at the end of last year/the beginning of this year, you had a large set of orders going into East Africa and if you could just update on the outlook for that business, particularly the buses, that would be great.

Dr. Raouf Ghabbour: Yes. The order book from East Africa was from GB Polo. It was a contract with General Motors East Africa which we are – it's a long-term contract and we are supplying it. We have actually succeeded to get an order from the Cairo Transport Authority for 300 city buses with a total value of USD 35.4 million. We are, we have got an order from Orascom (OCI) for 75 dump trucks. We have an order from [Osool] for 30 heavy trucks and trailers. Briefly, I can say that – we have an order for 600 light trucks with the Ministry of Interior. Briefly, I can tell you that we have an order book which we have not seen since 15 years. It is as if Egypt is being rebuilt from scratch, and I think – and I'm personally, I think that I'm personally getting involved in the deals and this is something I have never done during the last 15 years. But the volumes are becoming so big, I think that the CEO personally has to appear. So on Saturday, which is my weekend, I have an appointment at eight o'clock in the morning. I can't disclose the authority. But they are talking about something like 800 construction equipment. So you're talking about business which makes Egypt today the most important market to Caterpillar, to Volvo, to Komatsu, to Volvo Trucks and to Mercedes Benz. So commercial vehicle business, we are, I expect that we will be greatly compensated for the very miserable past seven or eight years.

Frances Ames: Great, thank you very much.

Operator: As a reminder, if you would like to ask a question please press *1 on your telephone keypad. We currently have no further questions over the audio.

Dr. Raouf Ghabbour: Okay, ladies and gentlemen, thank you for joining out call today and I hope we'll be able to give you brilliant results for Q3 hopefully in three months. Thank you.

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