GB Auto First Quarter 2016 Earnings Call

CEO's Call Script

- Good afternoon, ladies and gentlemen, and thank you for joining our first quarter 2016 earnings call.

- Here with me today are Mostafa El Mahdi, our CFO, and Menatalla Sadek, our Chief Investments Officer. I will begin this afternoon with a very brief overview of our performance in the first quarter, as I believe everyone has had ample time to read and consider our earnings newsletter. I will also discuss our outlook for the year as well as the current status of the automotive directive. Mostafa will then add some color on the financial highlights of the first quarter, and Mena has an update for you on our in-progress investments. We'll then open the call to your questions.

- Despite the challenges we face in both our home and expansion markets, we continue to be cautiously optimistic about the shape of the year to come. Demand in Egypt remains very strong and reasonably price insensitive. We have been actively passing on price increases, and consumers have taken them in stride after an adjustment period in the first quarter that lasted only several days. In that respect, we're ahead of other industries that have been reporting softness in pricing power and sharp declines in revenues in recent weeks.

- We also posted important market share gains despite operating in an environment marked by a shortage of foreign exchange and the specter of further devaluation. This remains an issue that concerns us. However, in the short term, it is but a blessing in disguise: we are the strongest market players and we know how to turn difficult situations to our advantage, a fact that will become even more accentuated in the quarters to come and that will see us post revenue growth. As you all know, the declines in our reported top line was mainly the result of a significant shortage of inventory at the beginning of the first quarter in addition to the very weak performance coming from Iraq. This was only partially offset by a very strong performance at our aftersales, Tires and financing businesses divisions.

- That said, there are bright spots in our results, almost all of which are underpinned by our investment in growth in recent years. This begins with our market share gains in passenger cars. The enduring attractiveness of the Hyundai brand played a key role here as our Hyundai market share rose to nearly 27% from almost 24% a year ago. But equally important in view of supply constraints was our drive in recent years to build a diverse portfolio of brands that competes across price points, with sales from Mazda, Geely and Chery sending our total passenger car market share to nearly 34% in the first quarter and a high of more than 39% in March alone. We therefore expect to see our group market share to remain above the 35% mark for the rest of the year as we continue to outplay competition in a tricky working environment.

- Those bright spots extend to commercial vehicles and construction equipment, where we will begin booking revenues later this year from contracts that will see us supply 260 buses on government contracts by the end of the third quarter. Our tires division is booming, our financing business is posting stellar results, and we see continued strong demand for both passenger cars and motorcycles and three-wheelers despite supply constraints (which are fading as we speak as we continue to build a longer than usual stock of inventory).

- In other words, the fundamentals of our business are strong. The challenges are in Egypt's macro picture, as well as the security and regulatory frameworks in our expansion markets.

- This theme of investing to smooth-out results in challenging times and position ourselves to win in a rising market will continue to be a hallmark of our strategy in the coming years. I know many of you are waiting for news of the automotive directive, which would give us incentives to guarantee the sustainability of our assembly operations and to enhance our profitability by erasing the significantly unexplainable advantage that certain importers have over local assemblers. I hope to deliver good news with that regards in the next few months.

- I see the directive as inevitable. Given the current macro environment in Egypt, Export-oriented manufacturing industries should be encouraged rather than discouraged. Empowering businesses to export gives them natural hedges against currency fluctuations.

- Whatever the advantages to individual businesses, it is inarguable that the ultimate beneficiary of medium-weight, medium-technology manufacturing is the nation of Egypt. Manufacturing creates jobs. It is a source of foreign currency. And it is a source of national pride.

- This is why we continue to advocate for the manufacturing directive. It is why we are pushing ahead with our plan for a motorcycle and three-wheeler manufacturing facility. And it's why we're eager to build our tires manufacturing facility.

- With that, I will hand the call over to Mostafa El-Mahdi, our CFO, for a quick look at our financial performance in the third quarter. Menatalla Sadek, our CIO, will then follow with some insights into these investments before we open the floor to your questions.

- Mostafa…

CFO's Call Script

- Thank you, Dr. Raouf.
- For the first quarter of 2016, GB Auto saw total sales revenues decrease by 8.6% year on year in the first quarter mainly due to the shortage of inventory at the beginning of the quarter as well as the negative impact of Iraqi operations.
- Overall, our operating profit increased 39.5% compared to Q4/2015, although it only increased 7.4% q-o-q. Net profit showed a slight decrease q-o-q, mainly as a result of the formal devaluation of 13.4% in mid-March, which resulted in a FORX loss from the revaluation of USD payables. The company continued to report positive minority interest due to the regional losses incurred, especially in Iraq where the low-oil-price environment is taking its toll on the economy, in addition to the regional over-supply situation with spill-overs mainly affecting Iraqi operations. Management has acted upon this by reducing regional fixed costs, which will pay off in what remains of 2016.
- On the cash front, as the company builds its inventory within an extremely difficult FX environment, we continue to rapidly use any generated cash for this purpose, which explains the negative cash flow from operations. Management believes that this is a strategic move to position GB Auto as the supplier of choice for consumers.
- As Dr. Raouf noted, GB Auto's market share was in the 39% range in March 2016, up from c.23% in March 2015. This is poised to further improve in all our lines of business as we have now replenished most of our stocks of Passenger Cars, Two- and Three- Wheelers, and Commercial Vehicles under challenging FX conditions. This is an operational hedge that we wouldn't have achieved had we not had access to excess liquidity at the end of 2015.
- The Group's net debt stood at LE 5.2 billion, an increase of LE 1.1 billion compared to 4Q15. Net debt to equity was maintained at c.0.88x as at March 31st 2016 from 0.9x at the end of Dec 2015. Total debt increased to LE 6.0 billion at the quarter, which includes LE 1.6 billion of financing business debt, as we continue to expand and grow our operations. The figure also includes FX exposure amount (a component of debt in foreign currency) of USD 90.6 million. GB Auto is looking to settle its FX debt promptly to reduce any devaluation risks in its main markets, Egypt and Iraq.
- As we continue 2016 with replenished inventory levels, a solid pricing strategy and a rather healthy market demand (despite the natural inflation), we are in a better position to reap the benefits of our high-growth markets than other struggling players in the industry.
- With that, I will hand over to Mena.. Mena…

CIO's Call Script

- …Thank you, Moustafa.

- Before turning to our investments, I would like to stress on the issue of both revenues and margins for a moment. Each of these points underscores our cautious optimism for the year, indicating that we are able to pass on price increases and control our costs.

- Revenues were down 8.6% year-on-year, but were up by 8.7% quarter-on-quarter as we were able to replenish our inventory in the second half of the first quarter. Obvious downside risk still remains, but the quick pace at which the market absorbed our price increases suggests we still have room to maneuver.

- Our pricing power and careful attention to cost control saw our gross margin rise 250 basis points year on year in the first quarter. What's more, our cost of goods sold in 2016 reflects all actual costs, meaning we're comparing real gross margins this year with overstated gross margins last year.

- On a like-for-like basis, that means our real improvement in gross margin is actually on the order of 350 basis points year-on-year, as promised.

- As to our new projects: We are very pleased that we've finalized technical assistance agreements with Bajaj. The agreements will give us the engineering data and technical know-how and expertise to allow us to manufacture Boxer 150 motorcycles and Auto-Rickshaw. Construction will begin with the component manufacturing hangers and the purchase of machinery and equipment for new painting and welding shops. We are definitely excited about the project, which we see as filling a market niche that has been very resilient over time to both political developments and economic shifts.

- Meanwhile, we are in advanced talks with strong technology partners to arrive at a final agreement for the regional tire manufacturing project. Our expectation is that we will produce a very strong lineup of car, light truck and heavy truck tires. The next checkpoint here will be the announcement of our OEM partner (when negotiations are finalized), and we would expect to have good visibility on the project location and an indicative timeline by then.

- Thank you, ladies and gentlemen this brings our remarks to a close. Operator, we're ready to take questions from call participants.