Company: **Ghabbour Auto**

Title: **Q2 2016 Results Presentation**

Presenter: **Dr. Raouf Ghabbour**

Date: **Monday 15th August 2016**

Operator: Good morning, good afternoon ladies and gentlemen. Thank you for joining our Second Quarter 2016 Results Presentation Conference Call. From GB Auto we have Dr. Raouf Ghabbour, CEO; and Mr. Abbas El-Sayed, our Group Finance Director presenting the Second Quarter 2016 Results. I will hand over to Dr. Ghabbour for his presentation, then we will have a Q&A session. Dr. Ghabbour, please go ahead.

Dr. Raouf Ghabbour: Thank you very much. Good afternoon ladies and gentlemen, thank you for joining our Second Quarter Results Call. With me here today is Abbas El-Sayed, our Group Finance Director. As usual I will walk you through our performance in the quarter and talk briefly about our outlook on the second half of the year, then hand the call over to Abbas for a deeper dive into our financials. We will then open the floor to your questions.

Ladies and gentlemen, I am obviously very pleased with our performance in the quarter. The challenges our markets face are clear, whether they are geopolitical in Iraq or macro in Egypt where the foreign exchange crunch hasn’t disappeared and where inflation has been running at a seven year high in the last two months. Despite this we delivered our best operational and financial performance since the events of January 2011 with fantastic growth in both our top line and margins. We reported nearly 23% top line growth in the second quarter and the 1.5 times increase in our bottom line. Our market share year to date is our best ever at 36% - that includes a record April where nearly one in every two passenger cars sold in Egypt was a GB Auto vehicle.

Passenger cars were clearly the hero of the quarter. It accounted for about 53% of our total revenue and grew at a clip north of 30%. Our decision to deploy all available liquidity to support our operations saw us capture a 38% share on the second quarter, reserving our volumes in a declining market as we launched new models and passed on price rises to the market that defended our margins. At the end of the day it came down to the simple fact that we had stock on hand to meet demand across the consumer spectrum while our competitors didn't. I'm also very pleased about our Egyptian financing and finance business. Financing revenues were up 92% and continued to be a key contributor to our bottom line. Tyres grew 80%. Commercial vehicles also did well, growing its revenues and margins as we continue to record good demand for buses and gained market share in trucks. Our tyre business has outperformed our expectations at both the top and bottom lines. We are seeing results coming from the growth of our brand and product portfolio and our premium distribution channels. Obviously we would have liked to have done better with motorcycles and three-wheelers, but the reality is that price rises weighed down on volumes. We made a conscious decision here to limit the pass-through of devaluation and are aware that the segment will probably remain price sensitive for some time to come. As you may have noticed while reviewing our results, we decided this quarter to separate out our Egyptian after-sales figures and our regional operations. We think this gives our investors more clarity on some of the fruits of our growth strategy in the past five years. It should also give you a sense of how strong our performance is in Egypt, our home market. Our high margin after-sales business is thriving with double digit revenue growth filtering down the income statement to rising gross margins as we continued to make good use of our expanded national network of after-sales.

Investments in passenger cars from our CKD facilities to the addition of new brands to our portfolio are also driving sales. Challenges definitely remain on the regional front where our results have been weighed down by the challenging situation in Iraq and Algeria. Throughout this we've been very conscious about keeping SG&A spending in check to ensure that our improved sales and margins have trickled down the income statement to our bottom line. We will maintain a careful eye on cost discipline as we go forward. Egyptian sales remained strong in July and we see signs that August will be a good month too. That said, September will be a challenge. Back to school season is always a slow time for automotive sales and as was the case last year, we'll have Eid al-Adha fall in September. The way the calendar looks set towards this year, the feast will dominate most of the week of 11th September. This comes at a time when inflation is running at a seven year high as I mentioned earlier.

Looking ahead, there is downside risk to consumer sentiment from both continued high inflation and from the ongoing foreign exchange crunch. The announcement on Thursday that we have reached a part-level agreement with the IMF for a $12 billion three-year facility will help, but this comes with it a short to medium term period of pain and adjustment, particularly given the devaluation of the Egyptian pound is a requirement of the loan, regardless of when it happens in September of at year end, we see the valuation resulting in a challenging quarter as the consumers adapt. We expect that will be followed by a multi-week or multi-month period in which the market [unclear]. Going forward we are also looking for news on the automotive directive which should give our CKD models an advantage similar to or greater than that now enjoyed by European Union, Turkish and Moroccan models.

We are also pressing ahead with our motorcycle and three-wheeler manufacturing project. We have finalised our technical assistance agreements which will provide engineering, data and technical know-how and expertise as we begin manufacture of the Boxer 150 and Autorickshaw models. We are about to begin work on our component manufacturing hangars and are purchasing machinery and equipment for the welding and painting shops. As we noted, we are reassessing our strategy for our entire project in light of feedback from OEMs and new opportunities that we are now evaluating. We are committed to growing the entire line of business in Egypt and regionally with the aim of increasing our supply of tyres and expanding our portfolio of brands.

Finally we are obviously watchful for signs that Iraq and Algeria to turn the corner, but I would again note that our performance in these markets are very much governed by local forces out of our direct control.

Ladies and gentlemen, the second quarter shows exactly what we are made of as a company. We have the ability to made tough, decisive calls such as our decision to deploy all available liquidity to support sales when our competitors had no stock. We have the right portfolio of brands at the right prices and fully diversified business that is growing up the value chain to include more manufacturing. The month ahead will continue to be challenging for Egypt in general and for our market specifically and yet I'm optimistic that as the economy stabilises following the economic and forex market reforms that are now coming, our whole market will be stronger than ever. There has never been a better time to bet on the power of the Arab world's largest consumer market.

With that I'll turn the call over to Abbas to walk you through highlights of our financial performance. Abbas, please.

Abbas El-Sayed: Thank you Dr. Raouf. In the second quarter of 2016 GB Auto saw its total sales revenue increase by 22.6% year over year and 34.4% quarter over quarter as the company continued to deliver strong performance due to the availability of stocks which were replenished in the previous quarter. GB Auto always tries to maintain a high level of operational power in order to increase its inventory levels allowing us to meet all requirements and cater to the market's healthy demand for our products. Despite relatively flat sales in the second quarter 2016, our gross profit margin is an indicator of strong year over year growth, coming in at 14.4% in the second quarter 2016 versus 12.1% in the second quarter 2015, mainly because GB Auto continues to effectively use its pricing power. Additionally our operating profit increased by 303 basis points compared to the second quarter 2015 and our net profit showed its strongest quarter since the year 2011 with a 3.2% net profit margin and increase of 106 basis points year over year. GB Auto also continued to report positive minority interest in the second quarter 2016 and it is important to point out here that there is a significant drop on both a year over year and quarter over quarter basis, mainly due to improved conditions for [unclear] as well as management's ongoing drive to reduce fixed costs which continues to reflect an improved result.

On the cash front the company continued to use any relatively generated cash flow for its inventory and the very soft foreign currency conditions which resulted in negative cash flow from operations. Management believes this to be a strategic movement to position GB Auto as a supplier of choice for consumers wishing to purchase any type of vehicle. Consequently GB Auto's market share climbed from 27.9% in April 2015 to a historical high 45% in April 2016. This is a clear sign of the success of the strategy implemented by management in the previous period and this operational hedge will help us to record one of its best quarters in terms of profitability.

The group's net debt stood at EGP 5.8 billion, an increase of EGP 700 million compared to the first quarter 2016. Net debt was at 1.38 times as at June 30th 2016 from 1.25 times at the end of March 2016. Total debt climbed to EGP 6.7 billion as at the close of the quarter and includes EGP 2 billion of financing business debt as we continue to expand and grow our operations. The figure also includes a foreign currency exposure equivalent to EGP 695.2 million which has decreased from EGP 804.3 million compared to the first quarter 2016. Overall GB Auto is in a very strong position in the market compared to peers since we have continued with our strong push to replenish inventory levels, meet market demand and utilise our pricing power successfully despite natural inflation.

That concludes my presentation for today. Ladies and gentlemen, the floor is now open to your questions.

Operator: Thank you. Ladies and gentlemen, if you wish to ask a question at this time, please press *1 on your telephone keypad. Please make sure that the mute function on your telephone is switched off to allow your signal to reach our equipment. Once again please press *1 if you wish to ask a question.

There are currently no questions over the phone sir.

Dr. Raouf Ghabbour: Great. Would you just ask them again?

Operator: Of course. Ladies and gentlemen, please press *1 on your telephone keypad if you wish to ask a question. We have our first question from Mehdi Kaoukabi from Duet Group. Please go ahead, the line is open.

Mehdi Kaoukabi: Hello. Thank you very much gentlemen for your presentation and congrats on a very good set of results considering the situation in Egypt especially for your business line. I have a couple of questions, I don't want to take too much of your time but let me run you quickly through them. So my first question is the affordability, we've seen that one of the reasons you kept on growing your top line is the increase in prices, so do you see any affordability problems going into the rest of the year, especially with the cut-off subsidies and such in Egypt? The second question is maybe just to give us a little bit of colour in terms of how are you sourcing foreign currency at the moment and maybe if you could be a little bit more specific when you talk about using any liquidity you can, are you using any dollars that you had from previous rights issues and such? My third question has to do with the…I guess your cash flow cycle, I understand you need to invest in inventory but it has been negative for quite some time now, so I guess my question is what are the conditions that would make it turn positive I guess? And I guess that's it for now. Thank you very much.

Dr. Raouf Ghabbour: In terms of affordability, yes, definitely we started feeling affordability issues in business lines like two and three wheelers. We could not pass through the devaluation to the consumer in full and that's why the gross margins have been affected. In passenger cars I did not feel affordability issues until the foreign exchange was at EGP 11.50 or EGP 12. Definitely beyond EGP 12, especially if combined with reducing subsidy levels on electricity and other services we should expect at some point to start suffering or start feeling affordability issues for passenger cars as well, but as things go in this market, the more devaluation you have, people are considering real estate and cars as a natural hedge against devaluation. So the more wealthy people would hedge the currency through buying real estate. The less wealthy will do it through buying a car. So as a matter of a fact during the last few months when the devaluation happened from almost EGP 8 to EGP 12.50, we have seen the demands on our products actually grow, until when I can't really foresee, but as I told you, I expect above the EGP 12 adding the impact of subsidy level reductions. We should at some point expect some affordability issues. What was your second question?

Mehdi Kaoukabi: My second question I guess had to do with the cash flow…the sourcing of the dollars, if you could explain to us right now how are you sourcing dollars and such?

Dr. Raouf Ghabbour: Actually our rights issue was mostly in Egyptian pounds, the majority. I would say more than two thirds was in Egyptian pounds, maybe one third was in foreign currencies. We felt that there was an opportunity in the market. We had a delay in our tyre manufacturing products and we decided to deploy the cash in that to capture that opportunity. So actually yes, we have used some of the proceeds…

Mehdi Kaoukabi: Sorry Mr. Ghabbour, can you remind me how much was that amount from the rights issue?

Dr. Raouf Ghabbour: I don't remember the exact amount, I think it was $30 million. At the time it was 240 out of 960, so less than one third…about 25% was in foreign currency. So yes, we have deployed all our financial resources to capture the opportunity and we have proven successful because we have made wealth. Regarding cash flow, cash flow, currently we have…of course we have increased our stock level because of many reasons. We were out of stock as you remember during the last quarter of this year and almost through the first quarter of this year. Now we are fully stocked across all business lines with products which are very saleable in the market, so that's definitely affected the cash flow. In the meantime we have added a very important line of business which was Chery which was non-existent in the first quarter and we have proved to be doing very well. Currently I think that we are selling about 800 units per month and it's acquiring a very significant market share. So cash flow, it was natural to see this reversal, but I expect going forward it will enhance us.

Mehdi Kaoukabi: Ok. Actually if you allow me I just have an additional question that I forgot to ask you, is the structure of your debt and the cost of your debt and the structure in terms of any foreign currency debt that you have versus local currency – that's what I mean by structure.

Dr. Raouf Ghabbour: Abbas, can you speak? The portion of foreign currency debt is about 10% or 12% of the total debt because it's about EGP 695 million out of…

Abbas El-Sayed: EGP 6.7 billion.

Dr. Raouf Ghabbour: So it's about 10%. And as you have seen quarter on quarter we are reducing it as much as we can. The structure of the debt is basically…

Abbas El-Sayed: Short term, the structure of the debt as well as there is a long term…This has been presented in the financial statement. You can see the long and short term.

Dr. Raouf Ghabbour: The long term debt is basically related to the finance business because both the consumer finance and the financial leasing businesses are lending over a period of five years and sometimes up to seven years, so that's basically the long, it's about EGP 2 billion. The short term debt is the balance and it is basically to finance the imports and our inventory basically.

Mehdi Kaoukabi: That's very clear. So the vehicles, actually cars and three wheelers, this you use only short term debt to finance working capital I guess; and all of the long term debt is not really…I mean, it's kind of a debt but basically it's part of the financing…

Dr. Raouf Ghabbour: The long term debt is basically finance business.

Mehdi Kaoukabi: Ok, that makes a lot of sense.

Operator: As a reminder ladies and gentlemen, if you wish to ask a question, please press *1. We have our next question from Hadeel El Masry from Arab African Investment Bank. Please go ahead, the line is open.

Hadeel El Masry: Hi everyone, thanks for holding the call. A question, maybe I missed it, can you tell us regarding your foreign currency, it's all private market or some foreign banks as well? And if there's any update on the automotive industry strategy from your side or the government side?

Dr. Raouf Ghabbour: You mean the sourcing of foreign currency?

Hadeel El Masry: Exactly.

Dr. Raouf Ghabbour: Sourcing of foreign currency, unfortunately banks are not allocating…I'm talking about this quarter, sorry, the last quarter, banks are not…almost non-existent. Very small, less than 5% maybe. Basically it's all from the market. The other question was?

Hadeel El Masry: If you can give us an update about the automotive industry strategy?

Dr. Raouf Ghabbour: The automotive directive or automotive manufacturing strategy has been approved by the cabinet on 12th July I think. It went to the legal people in the Ministry of Justice. It came back to the cabinet, it went to the President's office and I expect it to be sent to the parliament any day within the coming few days. Having said that, I think that the parliament has a list of priorities starting with VAT and all the laws which should be passed to guarantee the IMF loan to happen. So I think even if it goes to the parliament this month, I don't think it will be discussed in parliament before the next quarter. So I expect it to be ratified by the parliament any time in Q4 this year or latest Q1 next year.

Hadeel El Masry: Ok, thank you very much. Can I ask you to verify the question about your current inventory in terms of the passenger cars, how many months does it cover currently?

Dr. Raouf Ghabbour: We have to differentiate between fully imported cars and locally assembled cars. For fully imported cars we are actually working hand to mouth, so whatever goods are received this month are sold this month. For locally assembled cars we for strategic reasons are building stock, because some of the models we are assembling are not going to be available or supply will not be available from this year end and we will have to bridge a gap of production in our facilities until the successor model is ready later during 2017, so the majority of the stock you see in passenger cars today is CKD and it's built for that strategic reason.

Hadeel El Masry: Ok. Thank you very much.

Dr. Raouf Ghabbour: Thank you.

Operator: Our next question is from Michel Salameh from Arqaam Capital. Please go ahead, the line is open.

Michel Salameh: Hi everyone and thank you for the call. I just have a question with regards to the VAT tax, if you can shed some colour on that, how will that affect Ghabbour's operations and will you be able to increase prices even further if the VAT law is passed?

Dr. Raouf Ghabbour: In terms of passenger cars there will be zero change because today we pay 15% sales tax and in the VAT it's going to be actually 14%, not 16%, so there will be no price increase there. In commercial vehicles we are currently paying 10% VAT except for tourism coaches…sorry, 10% sales tax except for tourism coaches where we pay 12%. This will become 14%. I do not think that this is going to be affecting the business especially putting into consideration that it's going to be applied to all, so a 4% price increase will not harm the market.

Michel Salameh: Ok, great. Thank you.

Dr. Raouf Ghabbour: Thank you.

Operator: Our next question is from Amal Ragheb from GB Auto. Please go ahead, the line is open.

Dr. Raouf Ghabbour: Yes?

Operator: It seems that the participant stepped away. Please ladies and gentlemen, if you wish to ask a question you can press *1 on your telephone keypad. There are no further questions over the phone sir.

Dr. Raouf Ghabbour: Ladies and gentlemen, thank you very much and I hope that we'll have even better news in forthcoming quarters. Thank you.

Operator: Ladies and gentlemen, that will conclude today's conference call. Thank you very much for your participation, you may now disconnect.