GB Auto Full-Year 2015 Earnings Results

Results Conference Call Script

- Good afternoon, ladies and gentlemen, and thank you for joining our full-year 2015 earnings call.
- I will be somewhat more brief than usual this afternoon. First, I believe you have all had ample time to read our earnings newsletter. Second, I believe that the events of last week have, in many ways, changed the outlook for our company in 2016. We faced three major issues heading into this year: The foreign exchange crisis in Egypt. The need for an "automotive directive" in Egypt. And the ongoing challenges we face in our regional markets, particularly Iraq.
- The Central Bank of Egypt took a critical step in the right direction last week with its decision to devalue the Egyptian pound. It is our belief that that step will eliminate the biggest challenge to our business in the short- and medium-term.
- This step was long overdue. All of you know that we suffered significantly in 2015 due to a shortage of foreign exchange. The effect of the shortage was particularly pronounced in the final months of the year. The lack of foreign exchange had a sharp impact on our ability to import CBU units from summertime onward. The peak of the crisis came last fall, when it saw us stop assembly for a period of weeks in September and early October. The full impact of this stoppage is reflected in our fourth quarter results.
- Today, the CBE is actively working to close the gap between the official rate and the parallel market. It has also recently flooded the market, with some 2.4 billion dollars in liquidity to break the import logjam.
- The market is going to go through a period of adjustment. Bank liquidity is improving as a result of the devaluation. What's more, the CBE is backing state-owned banks in issuing certificates of deposit with high interest rates for investors converting U.S. dollars into Egyptian pounds. The interest rate on offer is attractive enough that global investment banks have made Egyptian debt and treasuries a theme going forward. In parallel, the Central Bank has promised that investors in treasuries and bonds will be guaranteed the ability to repatriate their funds.
- At the same time, the Central Bank raised interest rates 150 basis points this past Thursday in a bid to stem the inflationary impact of devaluation.
- This naturally raises the question of whether our market can absorb rising prices across all of our product categories, particularly passenger cars. I believe the answer is a resounding yes. We have continued to enjoy strong margins throughout this period. In fact, our gross margin in Egyptian passenger cars rose 4.2 percentage points in the fourth quarter while sales volumes were down nearly 41% in that period.

- As we have seen in the wake of previous crises since 2011, lost sales accrue as pent up demand. This demand will convert into sales provided we have sufficient FX available to bring in both cars and kits. The good news is, at the moment, we are nearly done building our inventory backlog, which should support us in the coming period.

- Having said that, I do caution that it could be some months before we see liquidity fully return to the foreign exchange market. With that in mind, we will continue to use our pricing power in the market not only to preserve margins for as long as possible, but also to have a buffer for any unforeseen developments. At the same time, we will maintain a tight rein on SG&A spending and work to preserve working capital. It's a playbook from which we have executed before, both during the currency crisis of 1981 and the devaluation of 2003. In fact, it is our view that the devaluation through which we're currently passing is a replay of the 2003 methods the Central Bank employed.

- In the meantime, we continue to see relatively good allocations of foreign exchange for our Commercial Vehicles and Construction Equipment division. Stimulus spending backed by the Gulf Cooperation Council nations has slowed somewhat, but the ongoing development projects in the Suez Canal Zone, in major urban centers and at projects including the new administrative capital give us hope that we will continue to see strong sales from this segment going forward. Motorcycles and three-wheelers has good inventory on hand and continues to post very strong figures. And the financing businesses remain among the stars of our group, adding significantly to our margins and serving as sales drivers for other core lines of business.

- That brings us to the most considerable challenge facing our Passenger Car business, namely the need for the government of Egypt to move on what has come to be known as the "Automotive Directive." This is a package of legislation that would protect the domestic assembly industry from what we see as unfair competition from Turkish, Moroccan and European Union imports. It would offer assemblers incentives in return for going further down the value chain and increasing the share of local components in manufacturing.

- It is our view that the government of Egypt needs to send two clear, strong signals to business and investors alike: That it is responsive to economic realities and that it will give priority to the development of medium-weight, medium-technology industry that will create jobs and grow exports.

- The state's stance on the first point is clear from the central bank's decision to devalue, raise interest rates and flood the market with foreign currency. It is time for action on the second point.

- The Minister of Trade and Industry Tarek Kabil has been supportive of our urging imports. We look forward to the legislation being introduced in the House of

Representatives in the coming months.

- It is difficult to overstate how important it is for the government to invest in industry. Equally clear is the impact pro-industry policies can have on national development. In fact, our key OEM partner Hyundai reminded me of that fact earlier this month when I led an Egyptian business delegation to Korea. After that trip, one of our U.S. investors reminded us that little more than a generation ago, Egypt had a domestic automotive industry. Korea had none. Today, Korea is an industrial powerhouse, with Hyundai alone exporting over 4.2 million cars each year. Korean brands are the market share leaders in Egypt. And yet we have no manufacturing industry to speak of. It is time for change.

- We are well-positioned for when that change comes. We have made substantial investments in our assembly facilities over the years, including the building of the first fully robotic paint shop in the MENA region. We have agreements with the best domestic parts manufacturers. We have preferential logistics packages in place that have allowed us to be cost-efficient. We have just introduced the Elantra as our second CKD brand from Hyundai. And with the FX situation now increasingly clear, we are will be able to rapidly roll out three new Hyundai CBU models, including two very desirable compact SUVs. Additionally, we have entered into a partnership agreement with Aboul Fotouh Automotive to distribute CBU and CKD models of Chery International’s passenger cars, with sales set to come on stream in the first half of the year.

- What we need is an enabling policy framework — one that will allow us to do with passenger cars what we are already starting to do with GB Polo: Serve growing domestic demand at the same time as we explore very promising regional export markets. It is, in fact, the same strategy we’re now rolling out with our manufacturing facilities for tires as well as for motorcycles and three-wheelers. On the tires front, we are now approaching the final stages of negotiations with potential technology partners to set in place the best product portfolio and deliver a competitive cost structure for the project. We are similarly finalizing agreements to install paint and welding shops with considerable localized components and processes for our motorcycle and three-wheeler facility.

- Our final challenge is in Iraq, where security conditions and the dumping by non-authorized parties of inventory into the market has sent our sales down by nearly 50%. Iraq is now contributing losses to our bottom line. Unlike in Egypt, we have limited visibility on developments in Iraq, even as we expand our sales of three-wheelers there. In the meantime, we are adopting a hold and see stance and continue to evaluate news there as it develops.

- Ladies and gentlemen, last week serves as a reminder of how rapidly things can change in emerging markets. By taking a long-term view to growing our business in very promising markets, we have positioned our business to maintain profitability in adverse conditions — and to thrive in good times. I am increasingly optimistic that 2016 will be the latter.

- 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 our investments before we open the floor to your questions.

- Mostafa…

GB Auto Fourth Quarter 2015 Earnings Results

Results Conference Call Script

- Thank you, Dr. Raouf

- For the fourth quarter and full year of 2015, GB Auto saw revenues decrease y-o-y by 23.0% and 0.5%, respectively, mainly as a result of the challenging FX environment in Egypt — especially towards the end of the year — as well as the turbulent Iraqi market throughout the full year of 2015. In Egypt, however, the decrease in sales of the passenger car division was compensated by the Two- and Three-Wheeler division, the Commercial Vehicles and Construction Equipment division, as well as our Financing business.

- Our gross profit margins meanwhile were quite strong in the fourth quarter and for the full year despite the slowing top-line performance. GPM came in at 15% in 4Q15 versus 11.8% in 4Q14, as a result of price increases the group introduced in the quarter, while full year profitability also improved as we closed the year at GPM of 13%. Overall, the company's net profit increased by 34.4% year-on-year in FY 2015, reflecting a onetime gain resulting from reassessing the fair value of an investment property by our subsidiary GB Polo, as well as lower taxes due to an overall lower tax rate of 22.5%.

- Meanwhile, the EGP 622.5 million in funds from operations that were accumulated during the first nine month of 2015, in addition to the outstanding cash balances of EGP 2.2 billion at the end of 3Q15, were allocated to build inventory towards the end of fourth quarter of year. This will work to boast performance in 2016 as we have now replenished most of our Passenger Car stocks, as well as Two- and Three-Wheelers and Commercial Vehicles, in a difficult foreign currency environment. This is an operational hedge that we wouldn't have achieved had we not had access to this excess liquidity by the end of 2015.

- The Group's net debt stood at LE 3.6 billion, an increase of LE **.7** billion compared to 3Q 2015, and decreased by LE 100 million compared to the final figure at the end of 2014.
  This has reflected on the following:
  - Net debt / equity reversed some of the gains achieved in 3Q15 — where it's stood at 0.7x as of 30 September 2015 — to close the year at 0.9x as at 31 December, 2015, which lower than the 1.3x as at 31 December, 2014.
  - Net debt / EBITDA closed the year standing at 3.5x which is similar to the last year
  - Total debt climbed to LE 5.2 billion at the end of 2015, and includes LE 1.3 billion of financing business debt, as we continue to expand and grow our operations. The figure also includes an FX exposure amounts to $ 85.42 million equivalent to LE 668.8 million. GB Auto is working to settle its FX debt promptly and has already succeeded to reduce it to $ 47.1 million at the end of Feb. 2016

- As we enter 2016 with a replenished inventory, a solid pricing strategy, and a rather healthy market demand (despite natural inflation), we are in a better position to capture the benefits from our high-growth markets. I'd like to re-emphasis here that as Dr. Raouf noted, we are optimistic that the recent steps taken by the CBE will begin to reflect positively — especially on our passenger car division — in the short and medium term. Meanwhile, we continue to operate a relatively lean company, with CAPEX for the full year standing at LE 290.3 million (compared to a depreciation expense of LE 255 million), leaving ample room for GB Auto's planned expansion in the Tires business and the Two- and Three-Wheeler business.

- That concludes my presentation for today, ladies and gentlemen, and before we open the floor to any questions you may have, Menatalla Sadek, our CIO would like to provide you with some insights into our investments
- Mena...

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- Thank you, Mostafa.
- I would like to say just a few words before we turn the call over to your questions, ladies and gentlemen. In a phrase, my message is this: It's time to get back to the basics.
- I've spoken with or met many of our recently. We've seen each other at investor conferences, had calls or welcomed you to our offices and our assembly facilities. Throughout it all, our conversations have focused on essentially one issue: Foreign exchange. We've talked through both the general issue and we've discussed whether GB Auto would have sufficient access to FX to continue its core operations.
- I relieved today to think that the next time we meet, we will dig into the details of the GB Auto investment story. And it is a phenomenal story — one that centers on a rapidly growing consumer market that will not be stopped by devaluation. Our population of 90 million people is growing at 2% every year. This year alone, a million people will reach working age — the age at which automotive purchases become an active consideration — in a market that has a motorization rate of just 33 vehicles per thousand people. This simple fact alone makes us very bullish on future growth prospects for our core market.
- We are ready to the revenue growth open to our current operations. But more significantly, we're positioning ourselves to capture an even larger share by going up the value chain. Doing so will let us capture not just more domestic demand, but to simultaneously penetrate new export markets, as we are now doing with GB Polo.
- Both of the major projects now in our pipeline are plays on this theme. We expect to announce in the coming quarter our selection of a world-class technical partner for our tire manufacturing plant. And we are in the final stages of documentation in our agreement with Bajaj to take our motorcycles and three-wheelers manufacturing facility forward.
- And to come full circle, I note that both of these investments — by the simple virtue of being export plays — will add to our base of foreign-currency revenues, helping lock-in the future FX needs of our Egyptian operations and serving as a natural hedge against future devaluation of the Egyptian pound.
- With that, I would like to thank each and every one of you who have stood by us through the challenges of the past years. I look forward to speaking with you in the months ahead not as a de facto spokeswoman for the Egyptian economy at large, but as the chief investments officer for the most exciting and most diversified automotive player in the Middle East and North Africa.

- Thank you for your time today.
- Operator, we'll open the call to questions from participants.