China Auto Logistics Inc.
2014 Second Quarter Earnings Call
Thursday, August 14, 2014 at 8:00 am ET

Operator: Good day, ladies and gentlemen and welcome to the China Auto Logistics 2014 Second Quarter Earnings Call. At this time all participants are in a listen-only mode. Following today's presentation instructions will be given for the question and answer session. If anyone needs assistance at any time during the conference, please press the star button followed by zero. As a reminder, this conference is being recorded.

Operator: I would now like to turn the conference over to Ken Donenfeld of DGI Investor Relations. Please go ahead, sir.

Ken Donenfeld: Thank you for those of you joining us on the phone and on the internet for this periodic update. We greatly appreciate your interest in our Company. On the conference call today will be several executives of the Company. These include Mr. Chin Yen, COO, Mrs. Wang Xinwei, CFO, Mr. Yang Feng, Financial Controller, Mr. Richard Sun, China Auto's Secretary, and Mr. Lawrence Wan, a member of the financial team. Mr. Tong has asked me to begin the presentation. Lawrence then will walk you through the numbers. Afterwards, with the assistance of Richard and Lawrence, who will serve as translators, we will have a Q & A period.

I will first read the required disclaimer regarding forward-looking statements. This conference call may contain, in addition to historical information, forward-looking statements within the meaning of the federal securities laws regarding China Auto Logistics Inc.

Except for historical information contained in our comments, the statements we make are forward-looking statements that are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements involve known and unknown risks and uncertainties, which may cause our actual results in future periods to differ materially from forecasted results. These risks and uncertainties include, among other things, product demand, market competition, and risks inherent in our operations. These and other risks are described in our filings with the U.S. Securities and Exchange Commission.

OK, I will now begin with comments from Mr. Tong.

Good morning, and thank you for joining us today. For those of you who have been CALI shareholders, the past few weeks have been very trying. For reasons we don't fully understand, and clearly are not of our making, our Company and its shareholders have been threatened by The Depository Trust Company or DTC, with what they term a "Global Lock."

This action would make it difficult if not impossible to effect trades in our shares and already has impacted our stock price. The letter from DTC was the result of a complaint by the Securities and Exchange Commission against five individuals who the SEC alleges engaged in improprieties with respect to the Company's shares.

Notably, the SEC did not point any fingers at us and we, in fact, publicly supported the SEC action. However, DTC has indicated that the alleged illegal trading is the underlying source of their action. Our view is that their action is misplaced. Among other things, it clearly disregards the highly negative consequences for all current shareholders who are far removed from the activities of the five individuals who were allegedly engaged in the illegal trading activity.

We have hired special counsel to help us fight the decision, which we believe could greatly harm our company and its shareholders - - and that's about all I've been advised I can say at this point. When there's anything more that we can say to our shareholders, we will.

I will only add here that the DTC decision comes at a time when our Company has been able to effect two of the most significant positive initiatives in its history. The first of these, just seven months ago, was our announced $91.4 million acquisition of the Tianjin Airport International Auto Mall. And most recently, on the heels of a very significant new rules change for imported cars announced by the Chinese government, we announced a strategic cooperation agreement with a major auto dealer leasing and development Company, which we think opens the door to an enormous growth opportunity for our Company over the next few years.

As more usual, I will now spend a few minutes discussing the quarter, before turning the floor over to Lawrence Wan, who will summarize the financials, after which we'll open the session up to your questions.

So, with respect to our second quarter. In short, the operating results were pretty much within the range of our expectations. Of course, we continued to deal with the economic slowdown in China as well as the increased competition in the space where we remain a leader, namely imported high end luxury automobiles. I should emphasize that while one of our key goals continues to be to grow our auto related services, where profit margins are much higher than the very thin margins in automobile sales, it is imperative that we maintain a leading position in the industry as a seller of imported luxury cars.

The good news in the quarter was that the shift in our sales mix we began in the first quarter - - to include more top end of the line luxury vehicles - - enabled us to increase our total revenues year over year. We did so by selling fewer vehicles at higher prices.

Further, while we reported a slightly negative gross margin, as described in our press release and 10-Q, this would have been above breakeven except for a small reserve we set up for a few slow moving vehicles from prior years. It was our goal to at least achieve stability on the bottom line, which I think we did, and I am hoping this will continue through the remainder of the year.

We also were able to decrease our reliance in the quarter on our three largest auto dealer customers – who last year accounted for 30% of sales and in the second quarter accounted for 19%.

Overall in the quarter, our gross margin was still not large enough to offset the anticipated increases we incurred in interest costs, depreciation and amortization stemming from our Airport International Auto Mall acquisition.

One reason for this was the dip in fee income revenue and the margins of our Financing Services business, where we again temporarily ceased to provide certain services in order to reutilize available funds to help finance our auto mall acquisition and lend working capital to Car King Tianjin.

While we saw the contributions to our operating income from our services businesses decline in the quarter, the contribution from Financing Services nevertheless continued to top all other segments as the interest income component of that business led to revenues that nearly matched the revenues in the same period last year. We also saw a small contribution to revenues from the International Airport Auto Mall as a result of payments made to the Company by Car King Tianjin, which is headquartered at the Airport International Auto Mall

Lastly, we had a small loss resulting from our share of the used car joint venture, which is still in the early stages of development.

Looking down the road a bit we see a very different picture from our results in the second quarter.

In particular, we have continued to review what may be the best possible utilization of the 26,000 square meter auto mall we acquired at the end of 2013. While we hope to see some further contribution in 2014 from this facility which is in an outstanding location near the Tianjin Airport, there also are longer term usage possibilities for it, including a retail auto sales showroom.

Of course, we also have our 40% equity position in the Car King Tianjin's used car business. Right now in China, new vehicle sales are about 75% of total auto sales and used cars are about 25%, which is the reverse of the figures for other developed countries around the world. We believe our Company is well-positioned to benefit as China moves in the direction of the rest of the world.

Even more exciting in our view is what we see ahead as a consequence of the strategic cooperation agreement we struck with Tianjin Binhai International Auto mall after the second quarter in August.

In short, we envision a substantial potential expansion of our high end imported auto sales coupled with our "one-stop" auto related services, anchored by the construction or acquisition of several new auto malls in selected locations throughout China. We anticipate the sales will be based on new e-commerce platforms we are developing based on our successful - - and sometimes not so successful - - deep experience with e-commerce sales.

We anticipate these sales will have somewhat better margins, while the additional services we sell will continue to have substantially better margins than our auto sales.

While high end imported autos represent a smaller "pond" for us to operate in than some of our competitors like Bitauto and Autohome, our goal is to be the biggest fish in this pond, where, in our view, growth should continue at a high pace over the next several years, especially as the economy picks up again.

The decision of China Auto and Tianjin Binhai Auto Mall to enter into the strategic cooperation agreement stems in part from the new rules for imported autos that were announced on August 1 by the State Administration for Industry and Commerce (SAIC) in China. In effect, these new rules will allow us significantly greater freedom to pick and choose imports that we think have the best sales potential. While they open the door to more competition, we are very confident that our experience and size provides us with a significant advantage.

Let me shift the microphone now to Lawrence who will briefly discuss the financial highlights of the quarter …. Lawrence?

Lawrence: Thank you, Ken. I will run through these numbers fairly quickly, as Mr. Tong's comments provided the explanation for many of them, and they are fully explained in the 10-Q we filed yesterday.

First, on the top line we saw second quarter revenues grow 3.11% to approximately $113,687,000 up from $110,256,000 a year earlier. This was mainly a consequence of the 3.2% year over year increase in Auto Sales which comprised 98.07% of all revenues in the quarter.

As Mr. Tong explained, the growth in Auto Sales revenues came as the Company shifted the mix of sales starting in the first quarter. In both quarters we saw the average selling price per vehicle increase to $106,000, which compared with $87,000 per vehicle in the second quarter last year. We sold 1,048 vehicles in this year's second quarter, 15% fewer than the prior year, but more than the 981 vehicles sold in the first quarter.

Once again our margins on Auto Sales were very thin as we lowered prices to beat our competition and maintain our leadership in imported luxury cars. As reported, we actually dipped slightly below breakeven in the quarter with gross margin on Auto Sales of negative .06%. However, this number reflected our decision to set up a reserve of $308,444 for some slow moving 2012 and 2013 vehicles.

Without this reserve, our gross margin would have been a positive 0.21%, which would have been higher than Q1 results, but slightly lower than in the second quarter last year. To this extent, we believe we continued to stabilize our bottom line and hope this will continue to be the case for the rest of the year.

It should be noted that results of our 40% interest in Car King Tianjin, our used car joint venture, are not included in Auto Sales results. We reported on a separate line that our share of the loss of this fledgling operation was $193,121; separately we noted that this operation had revenues of $604,766 representing automobile sales and commission revenue for an aggregate of about 220 used vehicles during the quarter.

Overall, gross margin in the second quarter was 1.33%, which matched the first quarter, but was down slightly from a year ago. This resulted mostly from the lower contributions to operating income from our higher margin services businesses.

In our Financing Services business, fee income decreased 38% in the quarter and margins declined to about 39% from about 63% a year earlier. This was because we temporarily stopped providing some services which allowed us to shift some funds to help finance the Zhonghe acquisition and provide a working capital loan to Car King Tianjin.

Revenues from Financing Services, though, benefitted from interest income and were less than 1% below what they were in the second quarter in 2013.

Continuing from the first quarter, we saw a small profit contribution for the Airport Auto Mall Automotive Services, based on rental income from Car King Tianjin.

While generating less income from our more profitable business segments, we also saw, as anticipated, interest expense in the second quarter grow to approximately $1,720,000, and depreciation and amortization expense of $667,000 - - both primarily stemming from the acquisition of the Airport International Auto Mall.

Consequently, the net loss attributable to shareholders in the second quarter was $1,846,254 or a 46 cents loss per share; down from net income of $800,484, or 22 cents earnings per share a year earlier

For the first six months of 2014, revenues increased to approximately $220,662,000 from approximately $217,881,000 a year earlier. The net loss attributable to shareholders was $3,192,422, or a $0.79 loss per share, compared with net income of $1,807,819, or $0.49 in earnings per share in the first six months of 2013.

Diluted weighted average common shares outstanding were 4,034,494 for the second quarter of 2014, compared with 3,694,394 for the same period of 2013.

I guess I'll now get back to Ken before we open up the Q & A portion of the conference. ------ Ken?

Ken: Thank you, Lawrence. Mr. Shiping just wanted to say again, that the Company is continuing to do what it can to support shareholders with respect to the DTC lock, and hopes shareholders can see the exciting possibilities ahead following a difficult couple of years.

With that, I'll ask the operator to please provide instructions for the Q & A period. Please keep in mind, as I indicated at the start, that at least today, we will not be able to answer any questions on the DTC matter. Thank you --- Operator!

Q & A Period

Ken: Well it appears that's it. Please, if any other questions arise, I hope you will give me a call. We appreciate your support and will keep you posted of any new developments that could affect your shares.

Operator: Ladies and gentlemen, that does conclude your conference for today. We'd like to thank all of you for your participation. You may now disconnect.