

China Auto Logistics, Inc.
2013 Year-End Earnings Conference Call
April 11, 2014

Operator: Ladies and gentlemen, thank you for standing by. Welcome to the China Auto Logistics 2013 Year-End Investor Earnings Conference Call. During today's presentation, all parties will be in a listen-only mode. Following the presentation, the conference will be open for questions. If you have a question, please press the star, followed by the one on your touchtone phone. Please press star, zero for Operator assistance at any time. For participants using speaker equipment, it may be necessary to pick up your handset before making your selection. This conference is being recorded today, April 11th, 2014.

I would now like to turn conference over our host Mr. Kenneth Donenfeld of DGI Investor Relations. Please go ahead.

Kenneth Donenfeld: Thank you, Luke, and thank you to those of you who are joining us on the phone and on the internet for this periodic update. We greatly appreciate your interest in our Company.

On the call today will be Mr. Tong Shiping, President of China Auto Logistics, and other executives of the Company, including CFO, Ms. Wang; the COO, Ms. Yuen (ph); Mr. Yang Feng, Financial Controller; Mr. Lawrence Wan, a member of the financial team; and Mr. Richard Sun, the Company's Secretary. Mr. Tong has asked me to begin the presentation. Lawrence will then walk you through the numbers, after which, with the assistance of Mr. Sun and Lawrence, who will be serving as translators, we'll have a Q&A period so that Mr. Tong and the others can answer your questions.

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 US Securities and Exchange Commission.

Okay, I will now proceed with Mr. Tong's comments.

Good morning to all of you. I'm pleased to have the opportunity to update you and perhaps answer some of your questions.

Our results were slightly delayed due to some complications relating to the very substantial acquisition we made in November, but I'm happy we could report to you within the required timeframe. When we last had a conference call, in mid-November last year, I told you that we continue to operate in a highly competitive environment and that our results would not be very good until we were able to flush out our weakest competitors. We would do this by continuing to offer our customers the lowest possible prices on the luxury imported automobiles they desired, together with our excellent service.

As you saw in the 10-K we filed yesterday, and the press release, the competitive environment continued through the year. As a consequence, our year-over-year margins continued to decline, resulting in only a small net profit by year end. Our revenues were impacted as well by the still slow economy, and the tighter regulation I described to you that began in the second quarter on imported vehicles, which created higher costs for our customers and disrupted our inventories up to through fourth quarter.

What I'm much happier about though is the news we were on the verge of reporting last time and now I can discuss more fully; namely, what I can now refer to as the successful completion on November 30th of the acquisition of Zhonghe Auto Sales, the owner and operator of the Tianjin Airport International Automall, as well as our agreement with Car King China to go forward with the launch of Tianjin Car King Used Car Trading Company, in which we have a 40% stake.

The opportunity to diversify our business away from Auto Sales began, and will continue, to focus on the development of higher margin auto-related services businesses. The best example of this is our financing business, which contributed the bulk of our profits in 2013, as it continued to grow.

Underlying our decision to enter the used car business in China is the fact that after years of increasing sales of new vehicles, including the luxury imported vehicles we have focused on, the demand for, and the sales of used cars has become a very substantial growth segment, as well, and it is one where we see a tremendous opportunity to utilize our auto industry experience and skill set.

To launch our effort, we chose to begin with a partner that already has had success in this segment, Car King China, based in Shanghai, with the hope that we can replicate and expand on that success in Tianjin. As part of our arrangement, we agreed to create a base for our efforts in what we believe is the single most desirable location for an automall showroom in Tianjin; namely, the Airport International Automall. It is literally surrounded by the leading automobile

dealers in our city, which you may know is the second most important port city in China, and actually the most important with respect to imported automobiles. We knew this site would be the main choice of any of our competitors and we wanted to be sure to beat them to the punch, even if it meant paying a premium price. Fortunately, with careful management of our cash flow, we were able to come up with a substantial first payment of over \$39 million and spread the remaining amount over the next three years.

With over 26,000 square meters of space in an ideal location, while we see the mall primarily as a base for our used car joint venture, we also envision some leasing opportunities that will help pay the freight, and also a space we can utilize for further diversification into a retail auto sales operation we are seriously considering. As you know, nearly all of our current luxury imported auto sales are to dealers in our large network throughout China. Direct sales to consumers would be a higher margin business, and I expect we will reach a decision on how or whether to proceed in a relatively short time.

There is another potentially exciting development, which we disclosed to you in our year-end press release, and that is that discussions are underway in high government circles to create what would be China's second Free Trade Zone, or FTZ, in Tianjin. For those of you who have followed the opening of the first FTZ in Shanghai, you can understand our excitement, as in its wake there have been substantial increases in valuations for real estate and companies in the zone. Companies in the zone will potentially benefit in a number of ways, ranging from decreased bureaucracy to lower taxes, to easier access to international capital, among other things. Happily, our new airport property is within what has been outlined as the Free Trade Zone in Tianjin, should it come to pass. While we are optimistic about this, I have to emphasize that it is not yet a done deal and other cities are vying for FTZs, as well. So, we are keeping our fingers crossed and hope we will see a positive decision on the matter within the next few months.

Meanwhile, other decisions by our national government have not been very helpful to us. We have described in our reports the tightened procedures and resulting increased costs with respect to imported vehicles. More recently, we have seen an edict by the new administration to strip government bureaucrats of some of their excesses, including their high-end imported vehicles. As I've explained, when you refer to high-end vehicles in China, you almost always are referring to imported cars. In any event, this is likely to have a further dampening effect on luxury car sales, even as we see a slowly improving economy.

As we stated in our press release, while we are aiming in 2014 to stabilize profit margins in our luxury car sales, we will continue to be in a competitive environment. Further, it will take at least the first half of the year for us to really launch our used car business, while some of key costs for our diversification are already in place. As a consequence, comparisons, at least through the first half

of the year, will continue to be difficult. Looking at the longer term, however, we believe we are in a much stronger position than ever, with some of the key building blocks for improved profits and continuing industry leadership now in place, so for the first time in a while, we are genuinely excited again.

With that, let me stop here and let Lawrence walk you through some of the financial highlights of the past year, and then I'll be happy to try to answer any questions you may have. Lawrence?

Lawrence Wan: Thank you very much, and hello again to those of you joining on this call on your telephone or through the internet. I will walk you through some of the financial highlights in the Form 10-K we filed yesterday, and then we'll be available with our management team to help answer any questions you may have.

As Mr. Tong stated, the past year continued to be a difficult one for our main luxury imported auto sales business, which comprised approximately 98% of our total revenues for the year. This was reflected in the 22.3% decline in revenues year-over-year to approximately \$459,235,000 in 2013, from approximately \$591,315,000 in 2012. Auto sales also generated smaller than usual income from operations in 2013, totaling about \$268,312, which could not be made up by contribution to income from our other auto-related service. This was the case even though financing service delivered growth once again in the fee income and was the biggest contributor to operating income, with approximately \$2.86 million contributions. Consequently, the decline on the bottom line was fairly sharp, with the net income in 2013 declining to \$524,260, or \$0.14 per share on about 3.72 million diluted common shares, compared with net income of approximately \$2.57 million, or \$0.69 per share, in 2012, on about 3.69 million diluted common shares outstanding.

As we have explained, certainly the slow economy had an effect on auto sales, as we saw a decline in volume of close to 27%, from 6,588 vehicles sold in 2012 to 4,837 vehicles sold in 2013. Additionally, most of the vehicles sold in 2013 were low-end models, although the average unit selling prices during the year grew 6.82% to approximately \$94,000.

As we explained in the third quarter report, there were two other key reasons for the decline. First, PRC Customs tightened inspection standards for imported vehicles, which prolonged our purchasing cycles and led to insufficient product to meet our customer demands. The PRC Motor Registration Office also enforced rules more strictly, with the net result being higher costs for our customers, which further reduced demand.

Together, with the reduced sales in 2013, we also saw profit margins reduce to about 1.49% from 1.9% a year earlier. As we have

explained, we continue our policy of providing our customers with the lowest possible prices against continuous stiff competition, with the goal of maintaining our industry leadership and perhaps moving some competitors out of the space.

Offsetting this to some extent was the continued contribution from our auto-related service business, especially financing service, as I have previously described. While interest income for this business was a bit lower, revenue from fee income grew just over 17% year-over-year. I should add that we had no problem obtaining credit facilities and loans that underline this business, and as of April 7th, 2014, we had credit line of a total \$159 million. We also see no difficulties this year obtaining additional credit line and loan facilities.

The other contributors to our operating income was advertising service, which, as you know, we have downsized considerably; automobile value-added service and automall management service. We announced recently, with regard to the latter, that as of February 27th, 2014, our agreement to manage the International Automall in Tianjin was not renewed, and in 2014, we will in depth focus on developing the recently acquired Airport Automall. It should be noted that we operated the new Airport Automall for only one month in 2013, following its acquisition in November. The contribution from this business in 2013's results was minimal.

Certainly, the highlight of 2013 was our \$91.4 million acquisition on November 30th of Zhonghe Auto Sales, which owns and operates the Airport Automall. This followed an agreement signed in November with Car King China to jointly launch a used car business, in which we have 40% interest. We anticipate the Airport Automall will serve as the main showroom of our used car business and also will provide us with some leasing opportunities. Over time, we believe this diversification will provide us with significant growth opportunities, improve profit and profitability. We are further excited by the possibility of being located in the much talked about Tianjin Free Trade Zone, which should provide us with additional benefits, if it comes to fruition.

As fully detailed in our Form 10-K, we agreed to the Airport Automall purchase for about \$91.4 million payable in four installments, with an annualized interest rate of 6%. The first instalment of approximately \$39.2 million was paid in November 2013. The three remaining payments are payable in November of 2014, '15 and '16.

Finally, as a consequence of the payment we made in connection with the acquisitions, we saw a decrease in working capital as of December 31st, 2013, to about \$16 million, compared with just over \$59 million on December 31st, 2012. While the Company will work to improve the level of working capital in 2014, we anticipate that it will not have sufficient cash flows to make the payments for the acquisitions and may need to seek outside financing. I can report

that we feel very comfortable about being able to obtain sufficient bank loans for this purpose.

Again, I will suggest you to consult our Form 10-K for additional details on our results, but our team here today will be happy to answer questions you may have.

With that in mind, let me turn the floor back to Ken.
Ken?

Kenneth Donenfeld: Thank you very much, Lawrence. Mr. Tong wanted me to say in closing, before the Q&A period, that while the Company has been feeling the impact of the tougher economic environment and tightened regulations in China, it continues to look to the future with confidence, bolstered by the steps it has taken to add a new leg under the table to support future growth. He hopes you will share his optimism for what he truly believes continues to be very excellent growth opportunities where CALI expects to be a leader.

With that, he would now welcome, as would the rest of the management team, any questions that you may have. So, Operator, could you initiate our Q&A session?

Operator: Thank you. We will now begin the question-and-answer session. As a reminder, if you have a question, please press the star, followed by the one on your touchtone phone. If you'd like to withdraw your question, press the star, followed by the two. If you're using speaker equipment, you may need to lift the handset before making your selection. Again, to ask any questions today, it is star, one on your touchtone phone.

Again, ladies and gentlemen, if you'd like to ask a question on today's call, please press the star, followed by the one.

Kenneth Donenfeld: Operator, this is Ken. I've gotten a couple of questions just emailed to me, so perhaps I'll begin. The question is: Could you give us a little bit more detail on the steps ahead to start up the used car business? Do you have a timetable for sales and profits? Then, in connection with the first part of that, could you tell us are you going to be selling domestic as well as imported cars? How big a role will internet advertising be playing in this business? So, it's a few parts to that question.

Richard Sun: Okay. (Chinese spoken)

Mr. Tong Shiping: (Chinese spoken)

Richard Sun: Well, Mr. Tong just now said that as the economies in China are growing, the country has more and more car consumers, and every year, there are more and more used cars. Currently, there are about 90 million used cars in the country, and Tianjin is an important port of the imported autos, but it's also a city with a big population, which offers us the opportunity to operate the used car business, and to seize this opportunity. Last year, in November last year, we completed the acquisition of the Tianjin Airport International Automall, and we had also set out a joint venture with Car King Limited, and we suppose next year we will have some (inaudible) financial figures to report. Hello, Ken?

Kenneth Donenfeld: Yes. You say it's going to take at least the first half of the year to get going. What steps of—how big a business do you think this can be in a year or two? Do you anticipate being one of the bigger players in this business?

Richard Sun: (Chinese spoken)

Kenneth Donenfeld: I'm sorry, a related question just came up. Could you talk about will the profit margins in this business be better than in your existing auto sales business and what kind of margins do you think are achievable?

Richard Sun: (Chinese spoken)

Mr. Tong Shipping: (Chinese spoken)

Richard Sun: Hello?

Kenneth Donenfeld: Yes.

Richard Sun: To your last question, we expect—we have anticipated higher margins that will be generated from the used car business than the sales of imported autos that we are operating currently; and regarding the size of the business in about two years, we anticipate that in two years, we may be able to sell about two—3,000 to 4,000 used cars a year.

Kenneth Donenfeld: Two thousand to 3,000 a year in two years, okay.

Richard Sun: No, 3,000 to 4,000.

Kenneth Donenfeld: Three to four thousand.

Richard Sun: Yes.

Lawrence Wan: On the joint venture itself, not just—we own 40%, so the joint venture will sell 3,000 to 4,000.

Richard Sun: Yes, thank you for reminding that.

Kenneth Donenfeld: Okay. Okay, Operator, I have a couple more questions here. I just wanted to see if there are any other questions on the line.

Operator: No questions on the phone line. Go right ahead.

Kenneth Donenfeld: Okay. I have a question here about—you said you might—you're thinking about going into the sales to consumers, retail auto sales. Could you talk a little bit more about that and what kind of opportunity you see there, and when you might make that decision?

Richard Sun: (Chinese spoken)

Mr. Tong Shipping: (Chinese spoken)

Richard Sun: Okay. Well, you know, since the new administration of China came into office in the year 2012, the government tightened the consumption of company-owned cars and we have witnessed a clear drop of governmental consumption, and to this situation, we don't think today is the right time to start our auto retailing sales. However, we have already prepared a complete commercial model for that, and we are ready to start the retailing business whenever we see the market begin to boom up (ph).

Kenneth Donenfeld: Okay. One part of the question that I asked before you didn't address. What will be the role of the internet in the used car business? You'll have a showroom, but will websites and so on be an important part of that sales process?

Richard Sun: (Chinese spoken)

Mr. Tong Shipping: (Chinese spoken)

Richard Sun: Today, we have worked out two phases to launch our internet platforms for our new used car business. In the first step, we will establish a platform by which we can manage the used car information system, and we'll also use it to promote our used car business, and in the second step, we will enhance this platform to bring in the sales of the used cars.

Kenneth Donenfeld: Okay. So, these will be new sites or existing sites?

Richard Sun: (Chinese spoken)

Mr. Tong Shipping: (Chinese spoken)

Richard Sun: The functions will be included in our existing website.

Kenneth Donenfeld: Okay, very good. I guess a couple of last questions here. People are asking could you tell us a little bit more about the Free Trade Zone. When might a decision be made about that? What possible benefits would there be to you?

Richard Sun: Sorry, Ken, when you say when the decision will be made, you mean the decision made by the government?

Kenneth Donenfeld: Correct.

Richard Sun: Okay. (Chinese spoken)

Mr. Tong Shiping: (Chinese spoken)

Richard Sun: Okay. Well, as far as I know, the decision by the government will probably be made in October this year, 2014, and the benefits that we can anticipate today include—well, for the time being, I have two points to share with you. First, when the Tianjin Free Trade Zone is approved, we may have better use of our foreign currency, which will facilitate our overseas purchase.

The second point is that when the Free Trade Zone is approved, we can anticipate the custom clearance procedures might be simplified.

Kenneth Donenfeld: That would help domestic sales, yes, okay.

Richard Sun: That will also shorten the time to deliver cars to our consumers.

Kenneth Donenfeld: Okay. The last question I have is on the margins in your auto sales business, which have been dropping due to competition. You say that you expect them to stabilize. Are you optimistic about the future of that business? Do you still see that as a growth business in the future?

Richard Sun: (Chinese spoken)

Mr. Tong Shiping: (Chinese spoken)

Richard Sun: Well, as previously I have mentioned that after the new administration of China, we have seen a clear drop of sales of imported cars and a clear drop in governmental consumption on the autos. However, we have also noticed some other points which are interesting, that, for example, actually, during the past two years, the volume—the quantity of imported autos didn't drop sharply,

and we can also anticipate that in the coming years, the consumption of imported autos will continue to grow, and more and more imported cars will be sold in this country and more higher competition we will meet in the future. Regarding the profits, I am still very confident with the imported car business in the country, and I believe we will be able to maintain our profitability. Ken?

Kenneth Donenfeld: Yes, okay. That's encouraging. Operator, are there any further questions?

Operator: I have no further questions on the line.

Kenneth Donenfeld: Okay. I guess—I have more here, but they're pretty much covering the same territory, so perhaps this is the time to say thank you to all of you who have participated in this call. Please feel free to call us with any additional questions you may have, and we thank you again for your continued support. Operator, that would be it then.

Operator: Excellent. Thank you. Ladies and gentlemen, this will conclude the conference call for today. This conference will be available for replay after 12:00 noon Eastern today. We thank you for your participation and you may now disconnect your lines.