VIAVID
communications simplified.

China Auto Logistics Inc.

2015 Second Quarter Earnings Conference Call

August 20, 2015

CORPORATE PARTICIPANTS

Jin Yan, *Chief Operating Officer and Vice President*

Yang Feng, *Financial Controller*

Lawrence Wan, *Financial Team Member*

Richard Sun, *Corporate Secretary*

Kenneth Donenfeld, *DGI Investor Relations Inc.*

PRESENTATION

Operator:

Good day everyone. Welcome to the China Auto Logistics 2015 Second Quarter Earnings Call. As a reminder, today's conference is being recorded.

At this time, I would like to turn the conference over to Mr. Ken Donenfeld of DGI Investor Relations. Please go ahead, sir.

Kenneth Donenfeld:

Well, thank you very much. Once again, it's a pleasure to welcome 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 Mr. Jin Yan, COO of the Company, and other executives as well. These include Mr. Yang Feng, the Financial Controller; Mr. Lawrence Wan, a member of the financial team; and Mr. Richard Sun, who is the Corporate Secretary. I've been asked by Mr. Tong to please read his remarks at this presentation. Lawrence then will walk you through the numbers, after which we'll have a Q&A period, so the executives here 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.

Now, I will begin with comments from Mr. Tong.

Good morning. Thank you for taking time from your schedules to spend it with us, especially given the continuing difficult environment in China which has had a continuing impact on our results. With this in mind, I will perhaps sound somewhat repetitive to some of you. Once again, we have had to report disappointing news; in particular, lower second quarter revenues compared with the same period in 2014, and a continuing squeeze in our cash flow, mainly due to high interest costs. These are stemming mainly from short-term borrowing, primarily related to completing payments for our $91.4 million acquisition of Zhonghe, which owns the Airport International Auto Mall in Tianjin. Especially given the tough year-over-year sales comparisons of our Auto Sales group, our hands have pretty much been tied in terms of pursuing the new growth possibilities we envisioned stemming from this acquisition until we get over the payment comp.

Despite the difficulties, we have remained very steadfast, you might even say very stubborn, in our belief that we can maintain our leadership position in the imported luxury car field and also successively complete our acquisition payments; also, that this will eventually open the door to once again becoming a growth company focused on new higher margin auto-related services and businesses. Certainly, there's no guarantee we will be successful. Indeed, since the end of 2014, we have included a going-concern paragraph in our financials for obvious reasons; namely, that our operating losses and negative operating cash flow may continue. Further, this may require us to obtain additional financing which may not be on terms that are acceptable. In short, it may not be possible to execute our business plan.

We are continuing to work hard to overcome this situation and continue to be optimistic. By themselves, none of the following reasons will be enough to allow us to achieve our vision, but taken together, perhaps they will.

First, in our core Auto Sales business, while the competition remains intense and forces us to compete on a price basis more than on superior service, we believe we have at least seen stabilization on the profit margin. In part, this stems from our decision to increasingly focus on sales of higher end vehicles and, as Lawrence will point out, our margins have improved slightly despite lower year-over-year sales.

Additionally, despite having to limit our most popular service due to reutilizing our working capital following the Zhonghe acquisition and the start-up of our used car venture, our Financing Services were the largest contributor to our operating profit in the second quarter. We still think the future of this business is bright.

In the second quarter, we also saw sales of our used car JV continue to increase, although it remained unprofitable. After the end of the quarter, as Lawrence will explain, we also saw our million-plus loan to the JV repaid. We think, over time, our used car business offers significant growth potential, which we hope can be translated into a growing contribution to our bottom line.

When you look at our results in the second quarter, it is revealing, and perhaps somewhat encouraging, to also see that EBITDA was positive. It points to the significant impact on our results in the quarter of approximately $1.9 million in interest expense, and depreciation and amortization expense of about $608,000.

There are other things behind our optimism. For some, the current state of China's economy is a glass half empty. This is reflected in recent headlines, such as "Is the drop in the yuan China's last hope for a turnaround?" We, however, are in the glass is half full camp. Some governmental actions are hurting us, such as taking away high-end cars from government officials. On the other hand, keeping in mind that China's slower growth picture is growth in GDP of around 7%, the bottom certainly hasn't fallen out, and shifting from an export economy to one led by domestic buying is something that we, as importers, certainly can embrace. While a lower yuan will tend to increase the cost of imports, we have found in our business over time that the more valuable the imported vehicle, the more likely it will stimulate interest from the new social climbers in China's society, even though they will seek the best price for the vehicle.

In the first and second quarters of 2015, we also have been significantly encouraged by other key government rulings that we believe may greatly benefit us over time. Specifically, in a few press releases we issued at the start of the year and then in June, we noted the decision to create a new Free Trade Zone in Tianjin, an FTZ, modeled on the one in Shanghai. This was followed by a government decision to implement a new parallel imported vehicle policy. As a leading independent or parallel importer of luxury vehicles in Tianjin, we see the government policy which places independence on the same footing as manufacturers who import vehicles making CALI one of the biggest beneficiaries of this new policy, and operating in the Tianjin FTZ from our new Airport Auto Mall, the largest in Tianjin, further brightens our outlook, in our view. It was with this in mind that in August of 2014 we entered into a strategic cooperation agreement with Binhai to launch a new retail auto sales business as soon as our situation permits.

I'll let Lawrence fill you in on some of the key numbers through the first half of 2015 in just a moment, but first allow me one brief comment on the recent tragedy in Tianjin that focused attention on our city in the front pages of newspapers around the world. Our own facilities were closed for a couple of days following the explosions, but thankfully, all of our employees escaped harm, although some had friends or relatives directly impacted. Further, our current assessment is that we do not see any significant impact on our businesses going forward. Lastly, we have offered our condolences to the families of those who lost their lives or were injured and hope that all necessary steps will be taken to ensure that we never see a tragedy like this again.

Lawrence, let's now spend some time on the numbers before we open up this call for questions. Lawrence?

Lawrence Wan:

Thank you, Ken. I will be as brief as possible given that we have published most of the information in our press release and the Form 10-K filing yesterday. If there's anything you wish to discuss in more detail, please feel free to bring it up in the Q&A session following our presentations.

Okay, starting with revenues for the second quarter ended June 30, 2015, these were down 17.6% to approximately $93,688,000, compared with the second quarter of 2014, as more than 98.3% of the 2015 second quarter sales were from our Auto Sales segment which continued to be hard hit by the economy and heavy competition. More specifically, in the second quarter of 2015, we sold 846 automobiles compared with 1,048 automobiles in the same period of last year. In line with our strategy, however, we saw the average selling price per vehicle increase to $109,000 from $106,000 a year earlier. This permitted us to generate a slight operating profit of about $37,000 in Auto Sales compared with a slight loss of about $122,000 a year earlier. As our gross margin shifted slightly higher, we began to see the stabilization we were seeking on the bottom line. We expect this stabilization will continue for the remainder of 2015.

Financing Services were again the second biggest contributor to revenues in the 2015 second quarter, despite an 11.86% year-over-year decrease in revenues to approximately $1,580,000. At the same time, net operating income in this segment increased to approximately $525,000 from approximately $283,000 in the second quarter of 2014, making this the largest profit contributor in the quarter. As we have stated, we think this is notable especially in view of the fact that during the quarter we limited the availability of our most popular financing service for dealers, as we shifted capital resources to support the early-stage growth in our used car joint venture and to meet our needs for cash flows with respect to the Zhonghe acquisition.

Despite these bright spots, limited contributions from our other business segments, including our Airport Automotive Services with a net operating loss of approximately $574,000, produced a net operating loss of approximately $298,000 in the 2015 second quarter. We point out that the operating loss from our Airport Auto Mall Automotive Services segment was, in part, a consequence of the rental income from our used car joint venture being deferred until this joint venture's liquidity improves and it can demonstrate an ability to remit its rental payments under the lease. After the quarter ended, however, we received repayment in July of a loan to the joint venture, which may permit us to recognize the previous deferred rental income on the joint venture in future periods.

The operating loss in the 2015 second quarter was actually only a small portion of the loss attributable to the shareholders in the quarter of approximately $2,245,000 or $0.56 loss per share. The major contributor to this loss was interest expense of over $1.89 million stemming primarily from the payable related to the Zhonghe acquisition and the short-term borrowings. We also had depreciation and amortization expense mainly relating to the Airport International Auto Mall of over $608,000, reflecting the EBITDA in the 2015 second quarter was a positive, about $101,000. I should add that these numbers compare with a loss of approximately $1,846,000 or $0.46 loss per share in the second quarter of 2014, and EBITDA in that quarter of a positive about $108,000.

As we reported, in the six months ended June 30, 2015, net revenue was approximately $181,039,000, down 17.96% from the same period a year ago, and also based primarily in the decline in Auto Sales, while in the first six months, despite positive contributions to operating income of approximately $115,200 from the Auto Sales and $645,300 from the Financing Services, the net operating loss in the period was approximately $1,067,000.

In the second quarter of 2015, this loss from operations was overshadowed by the interest expense of over $3.8 million relating to the Zhonghe acquisition and short-term borrowings which helped produce a net loss attributable to shareholders in the first six months of 2015 of approximately $4,912,000 or a loss of $1.22 per share. This compares with a loss of approximately $3,192,000 or a loss of $0.79 per share in the first half of 2014.

Looking at our balance sheet and cash flow statement as of June 30 of 2015, the Company had about $5.45 million in cash and cash equivalents, as compared with approximately $7.79 million at the beginning of the period and about $1.83 million as of June 30, 2014. As of June 30, 2015, the Company reported an accumulated deficit of approximately $244,000 and a working capital deficit of about $10.65 million. Throughout the first six months of 2015, the Company had negative operating cash flows.

I think I'll stop here, but please, if you have any further questions on this or any other topics, please feel free to ask them in the Q&A period, which we are now about to start. Ken?

Kenneth Donenfeld:

Thank you very much, Lawrence. I will, indeed, now open up the session to questions from our callers. Operator, could you please provide instructions?

Operator:

Certainly, sir. If you would like to ask a question, please signal by pressing star, one on your telephone keypad. If you are using a speaker phone, please make sure your mute function is turned off to allow your signal to reach our equipment. Once again, that is star, one if you'd like to ask a question, and we'll pause for just a moment to allow everyone a chance to signal.

Kenneth Donenfeld:

Operator, as usual, I'm getting some questions that people are asking me to ask, so I'll begin with the first question. It is: Could you talk some more about the Auto Sales picture? When do you anticipate a possible easing in the competitive picture in Auto Sales? What could happen to have this occur? Related to that, are you developing any new customers and new services to help sales?

Richard Sun:

(Chinese spoken).

Yang Feng:

(Chinese spoken)

Richard Sun:

Hello, Ken?

Kenneth Donenfeld:

Yes.

Richard Sun:

Yes, okay. Just now, Mr. Yang Feng took your question. He answered that, well, as everybody knows, the economic growth in China has encountered some difficulties and that the economic growth has been slowing down, so under this macro situation, it is natural that the consumption on the cars has declined. However, according to our own analysis, we can foresee that the consumption on high-end vehicles will resume in the year 2015, and the market share of low- and medium-end vehicles will decrease because now we have witnessed that more people have plans to change their cars and when they purchase a new car they would like to purchase a more expensive one.

Regarding the Auto Sales, the Company has planned to expand our sales directly to the consumer market and now we are planning some details how to implement that.

Kenneth Donenfeld:

Okay, thank you very much. I think that's a welcome answer, and it also—the next question that I got was relating to the strategic cooperation agreement which you referred to in terms of the retail sales. I have a couple of other questions here. The next question I have is regarding the used car business: It appears that Car King is getting traction. Do you see revenue growth continuing with Car King and how can you monetize your 40% equity stake in that business?

Richard Sun:

(Chinese spoken)

Yang Feng:

(Chinese spoken)

Richard Sun:

Hello, Ken?

Kenneth Donenfeld:

Yes.

Richard Sun:

Mr. Yang Feng, Mr. Yang answered that, well, Car King is an operator in the used car business and it operates its business all throughout the country, all throughout China, and in Tianjin, our JV with Car King is one its selling centers, sales centers in this city, in which have 40% of the ownership. So, whenever the sales grows in Car King, our benefit in this joint venture will also contribute more to our company.

Kenneth Donenfeld:

Okay, and are you—I guess part of that question, too, was do you see the growth continuing this year and next?

Richard Sun:

(Chinese spoken)

Yang Feng:

(Chinese spoken)

Richard Sun:

Ken, the sales results of the joint venture with Car King has demonstrated that its sales is growing, but we are not able to forecast how much the growth will be for next year.

Kenneth Donenfeld:

Okay, all right. Operator, are there any other questions, because I have a few more here?

Operator:

There are no questions over the phone, sir, but once again, it's star, one if you'd like to signal.

Kenneth Donenfeld:

Okay, then I'll continue with the questions that I'm getting. This question is about the Auto Mall: You purchased the mall for $91 million and change in 2013. Do you believe that the value of the real estate there has increased since Tianjin has become a Free Trade Zone?

Richard Sun:

(Chinese spoken)

Yang Feng:

(Chinese spoken)

Richard Sun:

Well, since the establishment of the Free Trade Zone in Tianjin, we have witnessed that the infrastructures have been improved with the efforts of the government and under this situation we can predict that the value of the real estate we have acquired will become more and more reasonable.

Kenneth Donenfeld:

Okay, thank you for that. The other question—I have a few questions on this, but I guess I'll summarize it into one, talking about the remaining payments that you have on the Auto Mall.

Let's see, I'll ask this one. One investor asks: Why don't you just sell your stake that you own and perhaps partner with somebody? Are you considering that?

This investor thinks that this would give you—increase the credibility of the situation and remove a big uncertainty in the stock right now. So, the question is: Are you considering or would you consider partnering with someone or selling your stake in the Auto Mall, given the hurdle that seems to exist about making these payments?

Richard Sun:

(Chinese spoken)

Yang Feng:

(Chinese spoken)

Richard Sun:

Well, Mr. Yang answered that, of course we will consider any opportunity to work with someone else. If such opportunity would bring us more cash flow or bring us more resources to increase our business or increase our sales, of course, we will consider that.

Kenneth Donenfeld:

Okay. I have a couple of last questions here, although we did address this in the presentation, it's a current topic: Could you talk about the effects on you of a lower currency, of a lower yuan?

Richard Sun:

(Chinese spoken)

Yang Feng:

(Chinese spoken)

Richard Sun:

Mr. Yang answered that, yes, I think the lower yuan will impact our business, but maybe not very significantly. In our business some of our transactions are settled in US dollars, and in this part, the lower yuan may have some result in our financial figures, but it will not be very significant.

Kenneth Donenfeld:

Okay. All right. Operator, if there are no more questions, I guess I'm out of questions at my end. Are there any other questions? Could you ask?

Operator:

Certainly. One more time, that's star, one if you'd like to ask a question. It looks like we have no questions at this time.

Kenneth Donenfeld:

Okay, all right. Well, in that case, that appears to be it. Thanks to all of you again who joined us on the call. The Company always welcomes questions from anyone. Please feel free to call me. Thank you very much again. Thank you, Operator.

Richard Sun:

Thank you.

Lawrence Wan:

Thank you.

Operator:

Thank you, sir. That does conclude today's call. We thank everyone for their participation.