Rassini Q2 and First Half 2016 Earnings Call Transcript

Francisco Freyre, Assistant VP, Investor Relations & Finance
Juan Pablo Sanchez, Chief Financial Officer
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10:00 a.m. ET

Operator: Good morning and welcome to Rassini's Earnings conference call for the second quarter and first half of 2016.

At this time, all participants are in a listen-only mode. Following prepared remarks, there will be a question-and-answer session. As a reminder, this conference is being recorded for replay purposes.

Please note that the accompanying presentation for today's conference call is available for download on the company's website at rassini.com. Alternatively, you can email Rassini at rassini.com and a member of the Rassini Investor Relations team will send you a copy of the presentation deck as soon as possible.

With that, I will now turn the call over to Francisco Freyre, Assistant Vice President of Investor Relations and finance for Rassini. Please go ahead, sir.

Francisco Freyre: Thank you, operator. Good morning, everyone, and thank you for joining us today on the call. With me on the line is Juan Pablo Sanchez, our CFO.

The second quarter of 2016 represented yet another record-breaking three months period. We maintain our positive momentum from previous quarters with sales and EBITDA both reaching record levels.

Sales for the quarter were 4,000 million Mexican pesos, a 25 percent increase year-over-year, while EBITDA increased 49 percent year-over-year to 808 million pesos. For the first half of 2016, sales increased 22 percent to 7,809 million Mexican pesos. EBITDA for the first half reached 1,587 million pesos. That's a 47 percent increase compared to the first half of 2015.

Consolidated net income before taxes and minority interest rose to 1,015 million Mexican pesos, an increase of 69 percent year-over-year. Some of the factors that positively contributed to our results included increasing demand in the NAFTA region, market share gains in both our Brakes and Suspension divisions, and sales from new contracts we secured in recent years. For EBITDA, results were driven by higher sales and enhanced product mix in the NAFTA region, lower utility prices, and further reductions to our EBITDA breakeven point. Demand for automobiles have continued to be strong the past six months as macroeconomic conditions remain favorable, particularly in the NAFTA region.

Rassini, which has technically advanced components and reputation for quality, continues to be well-positioned to benefit from this industry change. In a low growth and volatile environment, Rassini continues to outpace our industry and our country's growth. All initiatives we have implemented to bolster our revenues and maximize our profitability are producing increased value generation. In April, we announced Rassini's largest dividend to date, 1.5 Mexican pesos per share, returning a total of 480 million Mexican pesos to shareholders.

In other business highlights, this quarter, we started a second expansion of our new foundry in Puebla, Mexico. This expansion is supported by our strong sales backlog and will provide us with even greater production capacity to meet rising demand for our products. In connection with this expansion, we are adding a new molding line, which will increase our total installed capacity to 196,000 tons per year.

The total capital expenditures associated with this expansion is expected to be around $13 million. While financing this second foundry expansion, we also capitalized on our excellent track record and enhance performance to improve our Brakes division's existing debt profile. We reached an agreement whereby the existing debt will be bundled with the financing to execute the foundry's molding line expansion in a new on secure financing for five years with a 15-month grace period and a cost of LIBOR plus 2.25 percent, which is 26 percent lower than the previous financing.

We are also proud to announce that Rassini received yet another supplier award this quarter. General Motors granted our company the 2015 Supplier Quality Excellence Award, which is the highest distinction for quality conferred by GM to its suppliers globally. This award, which was only granted to a few selected Mexico-based suppliers, recognizes Rassini for top-tier performance, as well as having zero defects in 2015.

Lastly, our CEO, Eugenio Madero, was designated to participate on a panel at the SelectUSA Investment Summit in Washington, D.C. in June. As you may know, this is a prestigious event that brings senior government officials, C suite executives and other thought leaders together to discuss foreign direct investment in the United States. It was an honor to be recognized for our U.S. presence, as well as our commitment to innovation alongside all the global leaders. We see our involvement at SelectUSA as yet another example of how Rassini is increasingly recognized as an industry leader in both product innovation and global business.

If you will now turn to slide four of our presentation, I will provide an industry update. As I mentioned previously, the growth in the North American automotive sector, Rassini's main market, continue in the first half of 2016. This growth was primarily driven by macroeconomics condition.

We are seeing high housing starts, low gas prices, and an average unemployment rate of 4.9 percent, the lowest unemployment since May 2008. And with these favorable conditions, we remain confident of the positive trends we see in the automotive industry in North America.

On slide five, you can see that the seasonally adjusted annualized rate of U.S. light vehicle sales reached 16.6 million units in the U.S. during the month of June, and inventories closed at a level of 66 days' supply. Light vehicle production increased 3 percent year-over-year in North America with total production reaching 9.1 million vehicles in the first half of 2016, including 5.7

million light trucks. IHS experts forecast the production in North America will continue to increase through 2018 with annual light vehicle production expected to reach 18.3 million units in 2017 and 18.4 million by the end of 2018.

I will now turn to our consolidated financial highlight, which you can find on slides six and seven. As I mentioned in my operating remarks, we recorded a very strong first half of 2016. Consolidated sales grows 22 percent year-over-year to 7,809 million pesos and consolidated EBITDA grew 47 percent to 1,587 million Mexican pesos.

As seen on slide eight, sales in our main market, NAFTA, grew 29 percent compared to the first half of 2015. North America now accounts for 92 percent of sales while Brazil represents only 8 percent. Rassini's EBITDA continues outpace sales growth in the NAFTA region through the maintenance of our prudent cost structure.

As we have mentioned in previous quarters, our operations in Rassini continue to be affected by ongoing macroeconomic headwinds that have reduced demand and depreciated the local currency. However, Rassini strength in its core NAFTA region continues to more than offset lower volumes from the Brazilian business. Despite this environment, the Brazilian market remains as a relevant automotive cluster globally, and our presence in that market is strategic.

Moving on to slide nine, within NAFTA, sales in our Suspension division draws 35 percent compared to the first half of 2015. While our Brakes division sales grew by 18 percent. As a result, the total sales growth in our NAFTA business was 29 percent. And on the profitability front, EBITDA growth for the NAFTA region increased 51 percent during the first half of the year.

Again, results within Rassini's Brazilian business continued to be affected by the economic downturn. Review demand hampered sales in our Brazilian business, while EBITDA was reduced by a number of factors, including increased cost of electricity, gas, labor, and sales taxes.

Please turn to slide 10. We reported consolidated net income before taxes and minority interest of 1,015 million Mexican pesos, which is a 69 percent increase compared to the same period of last year. Net income for the first half was 854 million Mexican pesos and 81 percent increase compared to the figure generated in the same period last year.

On slide 11, you can see that net operating cash flow from the first half of the year grew 14 percent year-over-year to 1,114 million Mexican pesos. The consolidated cash balance was 975 million pesos as of June 30, 2016.

Moving to slide 12, as our operations delivered a strong cash flow, we continued to prioritize debt paydown. Rassini's consolidated debt as of June 30, 2016 improved to $144 million compared to the $188 million at the end of the same period of 2015. And consolidated cash balance at the end of the first half was $52 million, resulting in consolidated net debt of $93 million.

Please bear with me while we try to explain how this slide will look like now that we have finalized the new financial agreement for our Brakes division. In the Brakes division line, the short-term portion remains the same. Then the current portion will be zero and the long-term debt column will show a total of $36 million for a total of $46 million. For the amortization profile in the lower side of the slide, the Brake's amortization showing in yellow will be zero for 2016, $2.25 million for 2017, and $9 million per year thereafter, except 2021 when payment will be $6.75 million.

Our financial position and balance sheet continues to be strong as demonstrated on slide 13. Rassini's leverage ratio as of June 30 was 0.5 times net debt to EBITDA, which is a 44 percent improvement compared to the first half of 2015. And then interest coverage ratio improves to 10.2 times EBITDA to net interest expense.

In summary, we were very pleased to see yet another quarter of record-breaking sales and EBITDA. We maintain our positive outlook for Rassini's growth trajectory this year, particularly as we continue to see pent-up demand in North America. With Rassini's best-in-class components, our preferred business partners relationship with OEMs and our increased recognition as a leader in the automotive industry, we are confident that we are well-placed to capture additional market share as demand continues to climb.

With that, Juan Pablo would be happy to open the call for questions. Operator?

Operator: Thank you. [OPERATOR INSTRUCTIONS]

Valentin Mendoza: Hello. Good morning, guys. Congratulations on another quarter of record high.

I was wondering if we could please break down so we can have a little color on the performance of your growth. I mean, would you please give us some details on how much of this growth came from just the industry growth, meaning demand on NAFTA business, and how much of the growth came from new contracts and also from the extraordinary contract with the Asian OEM. Thank you.

Juan Pablo Sanchez: OK. Thank you, Valentin. The growth that we are facing is – as we see is resulting in the NAFTA – in the NAFTA region. As you know, as we mentioned in our last conference call and we have an extraordinary contract for the – this extraordinary contract is for two years, this year, 2016 and 2017.

The contract will represent sales, additional sales for the company in the order of $80 million. We are expecting $50 million this year and $30 million for the next year. The other part of the growth is driven by the industry. As you know, the light truck segment in North America region is doing very well. It's reflecting an increase of 6 percent compared to the last year. Those are the main reasons behind the growth in the volume.

Also, we have – as you know, we have been having additional contracts in the Brakes business, which also is benefiting in these results.

Valentine Mendoza: Thank you very much, Juan Pablo. This new contract in the Brake business is Audi, right?

Juan Pablo Sanchez: Yes. The main business that we will be launching during the second half of this year is the Audi business. As you know, Brakes was awarded with the Audi contract. The brakes for the Q5, the Q5 will be a bit in the Puebla plant and this Audi Q5 will be for the [inaudible].

Valentine Mendoza: Thank you very much, Juan Pablo. It's very useful.

Juan Pablo Sanchez: Thank you.

Hector Vasquez: Hi. Good morning, Francisco, Juan Pablo, and congratulations for the result. I was wondering if the expansion of the power plant will be for contracts that the company has in hand, or will it be for future new contracts? And at what capacity do you expect any plant [inaudible]? Thank you very much.

Juan Pablo Sanchez: Yes. The first part of your question is this expansion, the additional molding line that we will be building in the Puebla facility would lead to – in order to supply some contracts that we announced at the end of last year mainly focused in Fiat Chrysler, Ford and GM. OK?

The second question I didn't listen very well. Could you repeat that, please?

Hector Vasquez: Yes. It's – what capacity do you expect the new plant will start with?

Juan Pablo Sanchez: OK. This – the current capacity to decision of the brake business is 85 percent to 90 percent. That's why we are making this expansion, and this expansion will start operations at the end of next year or early 2018. And with this expansion, as you know, we are following the policy to make the expansions only if we have the contracts on hand. And this contract we will start supplying at the end of 2017 or early 2018. The new expansion, with the forecast that we have, will be running at, let's say, 85 percent also.

Hector Vasquez: OK. Perfect. Thank you very much.

Operator: [OPERATOR INSTRUCTIONS]

Guillermo Diego: Good morning. Two questions. First with the Puebla additional expansion. What should be the CapEx you're expecting for this year? And the second question is despite the increase in electricity and pricing which in this year you can see in increasing margin. Should we expect seeing pressure for the second half of the year?

Juan Pablo Sanchez: OK. The first question, sorry, there is noise in the line. But me a – let us answer to the second part.

The second part referred to the increase of the electricity that was announced early this month. With this increase for July, it's around – for us, it's an effect of – if we compare with the same period of last year, we will see an increase of 11 percent.

For sure, this will have an effect in the second half of the year. And based on our calculations, we are thinking that this increase will impart in the order of $500,000 in the second half of the year.

And please, could you repeat your first question?

Guillermo Diego: Yes. Your CapEx budget for this year.

Juan Pablo Sanchez: OK. The CapEx budget that we have for this year is maintenance CapEx as we have mentioned in the past represents 3.5 to 6, more or less, and we have to add this 30 million for the expansion of the brake business that we already discussed, plus we are expecting to have some additional CapEx in the order of 15 million. These CapEx are for meeting quality and some specifications required by our customers.

Guillermo Diego: Thank you.

Nicholas Prado: Hi. Quick question on your working capital. I realized that you have these new contracts and that at first probably requires more working capital. But if you could give us maybe an idea of where you expect it to stabilize given the significant increase in working capital needs this year.

Juan Pablo Sanchez: Yes. And we have shown increasing the working capital during this first half of the year. The reasons, as you mentioned, one is because the new contracts and the good performance that we are facing in the North America region. And the second part of the increase is also the increase in the taxes.

As you know, because we have been more profitable, we have to pay more taxes. We think that in the second part of the year, we will – I think that at the end of June, we have reached the highest level of working capital needs and we expect to stabilize that for the second part of the year.

Also, there is an effect that when we compare this against the last year, last year, the working capital was benefit for better conditions and terms negotiated with the suppliers and some – all the facilities that we have in the line of account receivables, as you know, that would be a one, let's say, one-time event. That being stabilized and then we see for the second half of the year to stable over capital needs only affected by the increase in taxes that I already mentioned.

Nicholas Prado: Very good. And just in terms of the effective tax rate as you mentioned, you're more profitable if you pay more taxes. Should we expect maybe in the long run-- should be a reasonable tax rate to expect?

Juan Pablo Sanchez: Yes. The tax rate that we are expecting, as we mentioned, is around 27 percent, 28 percent. We don't see any major change on that, but as you know, here in Mexico, we have to make some advance payments to the tax, and then the final adjustment is in the next year when we present the final tax return. This is the effective tax rate that we have is 27 percent, 28 percent.

Nicholas Prado: Very good. Thank you very much.

Juan Pablo Sanchez: OK.

Operator: And there are no further questions at this time.

Francisco Freyre: OK. Thank you all. Thank you all for joining us today. It has been an exciting quarter, and we look forward to updating you again in the next three months. In the meantime, please don't hesitate to contact us with any questions you might have. Thank you, operator.

Operator: You're welcome. And this conclude today's conference call.

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