

Rassini Q3 and First Nine Months 2016 Earnings Call Transcript

Francisco Freyre, Assistant VP, Investor Relations & Finance
Juan Pablo Sanchez, Chief Financial Officer
July 21, 2016
10:00 a.m. ET

Operator: Good morning, and welcome to the Rassini earnings conference call for the third quarter and first nine months 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.

Please that if you have not received the presentation, you can e-mail rassini@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 and thank you for joining us today. With me on the call is our CFO, Juan Pablo Sanchez.

As most of you are aware, Rassini has had a spectacular year to date. We are pleased to announce that this quarter we achieved record-breaking results yet again. Sales for the third quarter of 2016, we are MXN4.2 billion, a 26 percent increase year-over-year, making this quarter the highest third quarter in Rassini's history in terms of sales. EBITDA for the third quarter rose 31 percent to MXN782 million.

The first nine months also showed record levels of sales, EBITDA and net income. Sales for the first nine months were nearly MXN12 billion; EBITDA was MXN2.4 billion; and net income was MXN1.2 billion, a 59 percent increase compared to the same period in 2015. We are very pleased with these results.

Some of the factors that positively contributed to our results this quarter included the start of production on previously awarded new contracts, continued demand in the NAFTA region and market share gains in both our Brakes and Suspension divisions, as well as our continued efforts to improve profitability and further reduce our EBITDA break-even point in all of our divisions.

Rassini's commitment to maintaining a conservative leverage policy, in conjunction with our strong financial metrics and healthy cash flow has resulted in an upgrade of our long term credit rating by both Standard & Poor's and Fitch. This quarter the Standard & Poor's raised our rating from BB- to BB, and Fitch raised our rating from B+ to BB-.

In other business highlights, we received two prominent supplier award this quarter. The first was Daimler Trucks Masters of Quality Award, which we have received for two consecutive years; the second was General Motors Supplier Quality of Excellence Award, which recognizes Rassini for its outstanding performance in the Brakes division in 2015. Both awards reinforce our commitment to quality as well as our strong relationship with our customers.

Regarding our investment in productive assets, the second expansion of our Puebla foundry, which we mentioned last quarter, is going very well. The addition of the new molding line is on track to be completed next year as planned.

As a reminder, this expansion was supported by Rassini's sales backlog and contracts on hand; and the total investment associated with this expansion is

expected to be around \$13 million. We look forward to providing you with additional updates in the coming quarters.

Now, I would like to spend some time talking about our outlook for the automotive industry. If you will now turn to slide 4 of our presentation, you can see some macroeconomic indicators influencing the growth in the North American Automotive sector, which, as you know, is our main market.

We continue to witness positive macroeconomic conditions that influence automotive demand, such as high housing starts, low gas prices and an average unemployment rate of 5 percent, marginally higher than the last quarter but still historically very low. We remain very confident that these favorable underlying conditions in addition to the attractive financing rates will continue to sustain our process in North American.

On slide 5, you can see that the Seasonally Adjusted Annualized Rate of U.S. light vehicle sales, SAAR, reached 17.8 million units in the U.S. during the month of September, beating analysts' estimates. Analysts from Bank of America Merrill Lynch foresee a 1.8 percent year-over-year growth in sales estimated for 2016 in the U.S. auto industry; and inventories were healthy, tracking 64 days at the end of September. Light vehicle production in North America continued to increase throughout the first nine months of 2016, as you can see in the lower part of the slide; and total vehicle production was up 3 percent from 13.2 million in the first nine months of 2015 to 13.5 million in 2016. The experts from IHS continue to forecast production in North America to reach 17.9 million units in this year.

As a common practice across the industry, car makers continue to offer incentives and discounts during this quarter. Incentive spend increased in September, likely reflecting deeper discounting at the start of the month and around Labor Day weekend. It should be noted that, in spite of these incentives, the average transaction prices, which analysts estimate to be a more accurate indicator of the auto maker profitability, increased during this period.

I will now turn to our consolidated financial highlights, which you can see starting on slide 6 and then 7. Consolidated sales for the first nine months of 2016 rose 23 percent from last year to almost MXN12 billion; and consolidated EBITDA grew 41 percent to MXN2.4 billion.

If you will turn to slide 8, sales in our main market, NAFTA, grew 28 percent compared to the first nine months of 2015. North America accounts for 92 percent of our sales while Brazil represents only 8 percent. Rassini's EBITDA continued to outpace sales growth in the NAFTA region through the permanent control over the cost of structure which reduced the EBITDA break-even point in all of the divisions. And this performance was further supported by lower utility prices and resulted in EBITDA growth for the NAFTA region increasing 42 percent during the first nine months of the year.

Rassini's strength in its core NAFTA region continues to more than offset the lower volumes in the Brazilian business, which is still being affected by a changing economy in that market. The Company continues to enjoy its preferred business partner relationship with OEMs and remains positive about its trajectory for this year.

Moving on to slide 9, sales in our Suspension division rose 32 percent compared to the first nine months of 2015, while our brake division sales grew by 21 percent. As a result, the total sales growth in our NAFTA region was 28 percent.

As we mentioned previously, results within Rassini's Brazilian business continue to be affected by macroeconomics conditions in the country. Sales for the first nine months of 2016 were down 15 percent in terms of Mexican pesos, 5 percent down in local currency, and 5 percent in terms of volume compared to the previous year, which, in addition to the increase in the cost of electricity, gas, labor and sales tax, resulting in a decrease of 8.3 percent in EBITDA compared to 2015.

Turning now to slide 10 - as we have already discussed sales and EBITDA, I would like to emphasize just that the net income for the first nine months was MXN1.2 billion, a 59 percent increase compared to the same period last year.

Now, moving to slide 11, you can see that the net operating cash flow for the first nine months of the year grew 21 percent year-over-year to MXN1.65 billion. The consolidated cash balance at the end of the period was MXN1.2 billion.

On slide 12, Rassini continues to maintain a conservative leverage policy and a strict cost control for putting on cash generation, and, with this, we continue to prioritize debt pay-down. And our consolidated debt as of the end of September was reduced to \$147 million from the \$175 million that we had at the end of the same period of last year.

Consolidated cash balance at the end of the third quarter was equivalent to \$60 million, so resulting in a consolidated net debt of \$86 million at the end of the period.

Slide 13 illustrates our strong financial position. Rassini's leverage ratio as of September 30 was 0.5 times net debt to EBITDA, a 44 percent improvement compared to the first nine months of 2015; and the interest coverage improved to 9.8 times EBITDA to net interest expense.

In closing, we are very pleased with Rassini's performance so far this year. We have advanced in many fronts, from increased recognition from both our customers and the financial community; we generate record-breaking sales and EBITDA. These results allowed us to generate an important amount of cash flow, which we are using to invest in the future growth of our business and also distribute dividends to our shareholders. We maintain our optimistic view of the automotive industry, and are confident that pent-up demand will continue to drive strong sales, particularly in North America.

We look at the fourth quarter very positively; and we are looking forward to what it will bring to us.

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

Operator: [OPERATOR INSTRUCTIONS]

Jean Bruny: Yes. Sorry. Thank you, Juan Pablo and Paco, for the conference call, for education on the results. I think everything looks very good for you guys. You've been doing very great this year in terms of operating evolution, in terms of balance sheet, paying dividends and so on.

I just want to know if you have some challenges. What are the main challenges for you in the medium term? Do you think 2017 will be as supportive as 2016? Will you be capable of repeating the kind of operating evolution you have in 2016? And that will be it, basically. Thank you very much.

Juan Pablo Sanchez: Unfortunately, we can't hear you clearly. Could you repeat your question, please?

Jean Bruny: Yes. Sure. I just want to know if you see some challenges coming in the medium term; after a very good year you are doing in 2016? And if you will be capable of repeating the evolution you have this year next year as well? Thank you.

Juan Pablo Sanchez: We talk about the challenges for the next year - really, at this point in time, we are seeing, let's say, the level of production in North America in the range of 18 million units. Based on that, really, really, at this point in time we don't see any challenge that gives us a concern for the Company. The market is stable, the operations are stable, we are moving with expansions and we are starting the production of the new products and new orders for the customers on time.

Then we think that, based on these, we don't see, at this point in time, any big challenge for the rest of the year. However, we are always reviewing the

situation with the customers, the releases, the orders, and also the evolution of the economy in the United States in order to see if we face something that needs some immediate reaction for the Company.

Jean Bruny: That's it. Thank you very much.

Juan Pablo Sanchez: OK.

Alejandro Azar: Hi, everyone; thank you for taking my questions.

If you could give us more color regarding four decisions to shut down some plants for the F150 and some other plants in Mexico; and also from GM, what are your takes on those?

And if you could talk a little bit more about the Brazilian operations, mainly in terms of profitability; what are you doing there? Those are my two questions. Thank you.

Juan Pablo Sanchez: OK. Respect to the first question, Ford is making some adjustments in its production schedules in order to adjust the level of inventory. That was the reason of the announcement. Based on the information that we have, the orders that we have from Ford, we are seeing that in the rest of the year they will be stable and will be a small pick up in the production with Ford. Ford, as I mentioned, they are balancing the inventories, and that's why the reason of this announcement.

Alejandro Azar: So the temporary shutdowns would not affect your balance - at least until the end of this year?

Juan Pablo Sanchez: Yes; that's correct. There is no effect for us for that situation. It's, let's say, a temporary adjustment for us. And, on the other hand, we have to keep in mind that because we are leaders in the production of leaf springs, if one customer reduces production, for sure, other customers - we can say Ford, Fiat, Chrysler, et cetera - will increase the request of product for us. But, answering your question about Ford, we don't see any effect for us. OK.

Talking about Brazil - the Brazilian operation, they have a very good, third quarter; however, we are not seeing yet a recovery in the Brazilian economy or in the Brazilian automotive industry.

We are thinking that the Brazilian market will stay in the same way; and we can say that, based on information provided by the Auto Parts Association in Brazil, we are expecting an increase in the sales volume for the next year in a range of 5 percent - something like that. Then we are looking the Brazilian operations very careful and making the adjustments based on the information that we have from our customers.

Alejandro Azar: But in terms of efficiencies - because we see a major expansion in profitability around - I believe it was 700 basis points - will we continue to see the same levels maybe on a yearly basis for 2017?

Juan Pablo Sanchez: Yes. We can say that we think for the next year our target is to be in a range of EBITDA as a percentage of sales similar to the one that we presented in the third quarter. That is our target; and based on the information that we have, we see that could be reachable.

Alejandro Azar: OK. Thank you very much.

Juan Pablo Sanchez: You're welcome.

Jose Vasquez: Hi, good morning, Francisco and Juan Pablo.

How long would you be willing to keep sending production from North America to Brazil to stabilize operations?

Juan Pablo Sanchez: I beg your pardon? Could you repeat your question, please?

Jose Vasquez: Yes. You mentioned that you've been transferring some production from your North American facilities to Brazil in order to keep them running at a

steady rate. How long would you continue to do this considering next year is - we are seeing a 9 percent increase in volume?

Juan Pablo Sanchez: No. Yes; we understand the question right now. That production that we sent from North America to Brazil was on a temporary basis. Only one of the processes for the production of the leaf springs; the major part of that production will end this year. However, within the first quarter of 2017, we will be producing on a lower level. We can say, in other words, that we will almost finish this transfer of production at the end of this year.

Jose Vasquez: Great. Thank you very much.

Juan Pablo Sanchez: OK.

Luis Miranda: Yes. Juan Pablo, Francisco, good morning; thanks for taking my question.

Could you just give me an update on the impact of the expansion in the Puebla foundry in terms of install capacity? And if there is - what is the next material project that you have in the pipeline for expansion? Thank you.

Juan Pablo Sanchez: Yes. Today we are running the Puebla facility with a run rate of around 80 to 85 percent. The expansion that we started this year will be finished next year; and that expansion is for new contracts that we will be supplying by the end of next year or early 2018. And some contracts that we will be supplying is customers like Fiat, Ford, and also for the additional contract for the General Motors pickup trucks.

Luis Miranda: Thank you. And basically that capacity is for those projects only; or it gives you some spare capacity for future growth?

Juan Pablo Sanchez: This expansion is for this contract, and we will have our remaining capacity, but will be minimum. In other words, if we are able to get additional contracts from the OEM, we will need to review another expansion.

Luis Miranda: Perfect. That was very clear. Thank you.

Juan Pablo Sanchez: OK.

Hector Vasquez: Hi, everyone. Congratulations for the results.

My question is what was the additional volume coming from the recent contract with Audi during the third Q; and what should we expect for the following year within this contract? Thank you very much.

Juan Pablo Sanchez: Really, we are starting the production of the contract with Audi. We will see the major impact in the next year, 2017; and it is expected the production of 150,000 vehicles; and this is the number that provided by the OEM.

Hector Vasquez: Thank you very much.

Francisco Freyre: Thank you all for joining us on the call today. We look forward to updating you again with our results for the full year 2016. In the meantime, please don't hesitate to contact us with any questions you might have. Thank you.

Operator: This does conclude today's conference. You may now disconnect.

END