Rassini Q2 2017 Earnings Call Transcript

Francisco Freyre, Assistant VP, Investor Relations & Finance
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Operator: Good morning and welcome to Rassini's earnings conference call for the second quarter and first half of 2017. At this time, all participants are in a listen only mode. Following prepared remarks there we 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@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 and good morning everyone. Thank you for joining us on the call as we discuss our results for the second quarter and first half of 2017. With me on the call today is our CFO Juan Pablo Sánchez.

We are pleased to report a strong first half with increased demand, market share gains and the start of new contracts driving a 20% increase in net sales compared to the first half of 2016. Net revenue for the first half was $9.37 billion pesos, with EBITDA of $1.85 billion pesos and net income also increased to $876 million pesos or the equivalent to $2.74 Mexican pesos per share, an increase of 3% compared to the same period last year.

Sales for the second quarter of 2017 were $4.49 billion pesos which is an increase of 12% compared to the second quarter of last year. EBITDA also increased quarter over quarter to 853 million pesos. Consolidated net income for the second quarter was $419 million pesos.

We maintain an optimistic outlook for the growth of our business and as Rassini continues to deliver strong financial performance, we remain committed to creating superior value for our shareholders. Just a couple of weeks ago we paid a dividend of 640 million pesos or the equivalent to $2.00 pesos per share to our shareholders.

In other business updates, Rassini continues to receive customer recognition for our superior quality and operational excellence. This quarter, we received two prestigious supplier awards: the GM Quality Qxcellence award for our Flint facility making the second year in a row that that facility in Flint has been awarded this distinction, and also the Daimler Trucks North America Masters of Quality award for our North American operations supplying components for Freightliner and Western Star trucks. Both awards recognize Rassini for its commitment to quality and outstanding performance.

In addition to satisfying our customers, we also place great importance on taking care of our employees. This quarter we were honored to receive once again the designation of great place to work by the Great Place to Work Institute, which recognized Rassini for fostering an entrepreneurial environment where employees feel motivated and valued.

We have been pleased to see how over the years, Rassini has played an increasingly larger role in the global automotive ecosystem. Recently, Rassini was listed in Crain's Automotive News within the top 100 automotive suppliers in North America and for the first time, Rassini made it to their list of the top OEM part suppliers globally.

We have also been participating more than ever in conversations around global auto innovations, and were honored in June to meet with German chancellor Angela Merkel and Mexican president Enrique Peña Nieto, where we presented some of our technical innovations and reinforced why Rassini is an essential supplier to German customers such as Mercedes Benz, Audi, Volkswagen and Daimler Trucks, among others.

We will now turn to our industry update. On slide four you can see that macroeconomic conditions continue to be positive in North America. Unemployment continues to drop; fuel costs remain low and housing starts continue above a million houses.

Turning to slide five, the Seasonally Adjusted Annualized Rate or SAAR for the U.S. light vehicle sales was 16.4 million units during June of 2017, and also June inventories closed at a level of 74 days' supply which is 14 days above the industry ideal of 60 days' supply. And while total North American light vehicle production was down approximately one percent compared to the first half of last year, production of light trucks actually increased 3% year over year.

Over the past few months, we have received questions from many of you about these trends and whether we have seen the peak of the market. What we are seeing is that U.S. light vehicle sales figure appears to be stabilizing in the mid 16 million-unit range, and this level, while slightly lower than the prior months, is still strong and analysts have noted that the auto industry is still seeing record average transaction prices, rich segment and retail / fleet mix.

The stability in U.S. vehicle prices and other strong industry dynamic such as those mentioned in the previous slide have confirmed as well as the IHS continues, sorry, as well as IHS continued to forecast relatively flat or lower U.S. auto sales in 2017, that is corresponding to our vision that it will climb back up to as much as 17.9 million units by 2019.

These factors are showing that the U.S. auto sales will remain positive during this remaining part of 2017 at a time that we continue to capture market share, focus on operational excellence and pursue opportunities in all categories including premium cars and heavy trucks.

Moving on to our financial highlights and results starting on slide seven, we reported strong financial performance in the first half of the year with notable year over year improvements to both sales and EBITDA.

Slide 8 shows our sales and EBITDA by regions. Sales in the NAFTA region remained robust and we are also beginning to see the Brazilian market to stabilize. Sindipeças, which is the auto parts forecaster that we use in Brazil, forecasts that production in that country during 2017 will increase 10 percent compared to 2016, and that we will see signs of recovery and growth of 4% for the following years. Our North American business generated 91% of our sales and 98% of our EBITDA in the first half of 2017 increasing 14% year over year with our Brazilian operations providing the remaining 9% of sales and 2% of EBITDA.

Turning to slide 9, we see North America sales in our suspension business rose 15% compared to the first half of last year while sales in our brakes business rose 24%, contributing to an overall 19% sales growth in our North American business compared to last year.

As shown on slide 10, we reported $1.14 billion pesos of consolidated net income before taxes and minority interest. That is a 12% increase compared to the $1.02 billion for the first half of 2016, and net income for the first half of 2017 increased three percent to $876 million pesos from the $854 million back in 2016.

Moving on to the slide 11, net operating cash flow grew 23% year over year to $1.37 billion pesos for in the first half of 2017, reflecting improvements to the Company's sales and EBITDA as well as the adequate management of working capital. Our total cash balance as of June 30, 2017 was $2.1 billion pesos which is equivalent to $117 million U.S. dollars.

In slide 12, there are some highlights that our consolidated net debt balance was decreased to U$29 million as of the end of the second quarter. That is down compared to the U$93 million as the end of the same period back in 2016.

Turning to our financial ratios on slide 13, our leverage ratio as of June 30, 2017 remains at 0.2 times net debt to EBITDA with an interest coverage ratio of 12.1 times EBITDA to net interest expense.

In closing, I would like to reiterate that we are pleased with what we have accomplished in the first half of this year. As we know, the automotive industry is challenging and Rassini has demonstrated its capabilities to evolve with changing market conditions and we continue to do so while maintaining the commitment to technology development, quality, reliability and innovation. These are the attributes that brings our customers back time and time again and that create supplier relationships that last for decades, create value for our shareholders and collaborators and we will continue to pursue excellence in all of these areas.

With that, Juan Pablo and I would like to take some time to take your questions. Operator, you may now open the line.

Operator: [OPERATOR INSTRUCTIONS]

(Mauricio Serna): Hi, good morning and thanks for taking my questions, I have a couple if I may. First on the volumes talking about the second quarter particularly on the coil springs we saw deceleration or actually a drop in pretty much the springs you know because they were weak compared to the first quarter. It just seems like there's a disconnect to good trends of light trucks, so if you could just elaborate maybe on what happened in this quarter.

And also, if you're keeping, you mentioned in the first quarter a guidance of mid single digit volume growth. Is this whole being this, are you keeping this guidance?

And then on the margins you know it seems like the inflection in Brazil is the volume's finally showing also in the margins but looking at North America margins, NAFTA margins in the second quarter there was 130 BPS contraction. Maybe you could just elaborate a little bit more what were the headwinds that you faced in this particular quarter?

And finally, on the cash flow statement, you report in these other lines of 100 million outflow for the first half and that implies a 300 million in the first half – in the second quarter. Just wanted to get a little bit more insight on what does this other include? Thanks, and sorry for if it's too many questions.

Juan Pablo Sánchez: OK (Mauricio). First your question about volume, we have mentioned since the beginning of the year that our expectation for 2017 is to be in the case of leaf springs with a volume increase around one percent to two percent above 2016.

We had to take into consideration that during 2016 we have an extraordinary contract with one customer and that contract is almost done during the, this first quarter of 2017. With this I meant that during the first quarter 2017 we still supply part of this extraordinary contract and that's also affecting our volume for the second quarter, OK.

The – your question about how do we see the second quarter about market, we mentioned also in the past conference call that the one of the main effects, negative effects for the company would be the increase of the energy and gas. These two items affected the second quarter almost 0.8 to sales, and this is because the energy increase above around 50 percent compared to the last year. For the rest of the year we are expecting to have an EBITDA margin around 19.5. It depends on this part of the energy.

With respect to the question of the order in the cash flow, in the order we have some items like the profit sharing. Also, during the first quarter 2017 we incurred some severance payment in Brazil because we layoff some workers in order to adjust our operations. Also in this line, we presented a concept that we have named tax deconsolidation.

That is an impact in cash flow that we have been pegging every year and this is related to the termination of the tax consolidation that took place in at the end of 2013. For the second half of 2017, we are not expecting a high difference in this line.

(Mauricio Serna): OK, thanks a lot. Just a quick follow up, did that EBITDA margin that you mentioned 19, 19.5 that's at a consolidated level I suppose. And also, we wouldn't be expecting therefore any additional severance payments from Brazil I guess.

Juan Pablo Sánchez: Yes, that's correct. And at this point in time because during the second quarter 2017 in Brazil there is a significant demand, Brazilian automakers are producing trucks for export and we have seen that during this maybe this second part of the year we will have an increase around 20 to 50 percent in volume currency in the Brazilian operations.

We are reviewing this with the Brazilian team if this is something that will be sustainable for the fourth quarter because it seems some kind of export to Europe that we are trying to understand if this will last more time, OK.

(Mauricio Serna): OK, thanks very much. Thanks for all the answers and congrats again on the results.

Juan Pablo Sánchez: Thank you.

(Valentin Mendoza): Good morning guys, thank you for taking the question. But first what is, I was wondering if you could give us some color this extraordinary contract that impacted the performance in the second quarter. Until when are you guys producing this contract and do you foresee additional impacts on your profitability coming from the scale down in this contract?

Juan Pablo Sánchez: Yes hi, good morning. This contract we explained that since last year that one customer asked us to supply a contract for around $80 million and that would represent sales for let's say 15 to 17 months. And we had started to supply that in the first quarter of 2016.

Right now, it's almost at the end, we are in talks with the customer. If this customer will need additional volume we will prepare that. And that was let's say a, that volume help us to leverage our operating leverage and increase the margin because was let's say a good price in that contract.

(Valentin Mendoza): Thank you very much Juan Pablo. Just to fully understand, this contract is for multi spring, right multi leaf spring or is this coil spring? Because I would like to fully understand the underperformance that you got in this quarter for the volume in, I mean you only grew 0.3% of volume in springs and more, and coil springs decreased five%, right?

So, I'm trying to fully understand if coil springs had to do with the scale down for the compact vehicles in North America which most of them have coil springs instead of multi leaf for the pickups.

Juan Pablo Sánchez: Yes, this contract is leaf springs, OK. That's why when we mentioned that we are expecting volume increase in 2017 of one% from 2016 is because in this year 2017 we are not having the full year of this contract but we are compensating partially with new contracts for the heavy truck segment, and this is in the case of leaf springs.

(Valentin Mendoza): And for coil spring had to do with the scale and for the compact vehicles, right in North America?

Juan Pablo Sánchez: Yes, that's correct.

(Valentin Mendoza): OK. Thank you very much guys.

Operator: [OPERATOR INSTRUCTIONS]

(Guillermo Diego): Hello Juan Pablo, congratulations on the report, pretty much in line with the guide that you had given us in the beginning of the year. And just one question, regarding working capital the accounts payable specifically we have seen the number going down from 80 to 60 days. So, any specific issues that you are having there and what is expectation towards the end of the year? Thanks.

Juan Pablo Sánchez: This number is comparing 2016 against 2017 (Diego)?

(Guillermo Diego): Yes, yes.

Juan Pablo Sánchez: OK.

(Guillermo Diego): (Inaudible) you have the 72, 62, 60.

Juan Pablo Sánchez: Yes. One of the reasons is that in the Brazilian operations during 2016 we enjoy on a program called suppliers facility. Unfortunately, because of the crisis in Brazil this facility was cancelled, OK and then we have to reduce the terms payment with the suppliers and that's why 2017 you are seeing that reduction and we will stay in this level for the rest of 2017.

(Guillermo Diego): All right, thanks.

Operator: [OPERATOR INSTRUCTIONS]

(Jose Vasquez): Hi, good morning Juan Pablo and Francisco. My question is regarding the coil springs that we see a small contraction of five percent in volumes so what do you attribute this? As you previously mentioned, leaf springs there's no material change due to the extraordinary contract from last year but on coil springs the decline, the sequential decline is just pretty big. So, if you will kind of share on that please.

Juan Pablo Sánchez: Yes Jose, the reason in coil springs is more related to the behavior of the passenger car trend in the market. As you see, the passenger car sales are facing volume reduction in compared to 2016 because the shipping the demand, the demand in that space right now is more for crossover light trucks than cars and coils are more devoted to the passenger cars.

(Jose Vasquez): OK, thank you very much.

(Alejandro Azar): Hello Juan Pablo and Francisco and thank you for taking my questions. I don't know if I got the number right if you mentioned that the energy, higher cost of energy impacted your first half margin by 80 basis points. I don't know if you could give us a breakdown because if you could explain how the prices of steel affected your margins. I don't know if you're accounting for those on sales during this quarter if you could explain more of that.

Juan Pablo Sánchez: Yes, it's more related to the energy. The effect that we mentioned is more related to the energy. With respect to the steel, remember that we have 100%

steel pass through with the customers. Then we can say in that regard we don't have any negative effect in the profitability.

(Alejandro Azar): But how it affected the sales performance because you had a price mix, right during the quarter. Does the price of steel affect the sales performance upwards or downwards during the quarter?

Juan Pablo Sánchez: No the steel price sorry, the increasing the cost of the steel also is reflected as an increase in our selling price in the quarter.

(Alejandro Azar): OK. OK and another question if I may regarding the volumes in Brazil, are those volumes new contracts awarded in past years or this is just from current customers a recovery in the market?

Juan Pablo Sánchez: Those are current customers and the main customers are Scania and Man. And they are following those customers are following a strategy to export trucks to Europe mainly.

(Alejandro Azar): OK, perfect. And one more if I may Juan Pablo, you mentioned that you are expecting margins of 19 and 19.5 for the rest of the year. My worries are that prices of natural gas are still going up and then the (CFC) will try to increase the price of electricity. From the analyst side, also we expected an FX of almost 19.5 and those expectations probably are coming lower. Are you taking to account these factors for those 19 and 19.5?

Juan Pablo Sánchez: I would say that we are considering that in the range that we gave you. We see it stable for the rest of the year these margins that we already mentioned.

Operator: And again to ask a question, please press star then the number 1 on your telephone keypad. That's star 1 to ask a question. And your next question comes from the line of Jean Bruny from BBVA.

(Jean Bruny): Hi and thank you for taking my question. Basically, all my questions have been answered, maybe just one left it's on your debt. Are you considering refinancing the debt for next year or are you in the process of doing it or are you still waiting for by year end to do so? Thanks.

Juan Pablo Sánchez: Hi, no, we are not thinking to refinance the debt for the rest of the year. We will be meeting (with) obligations according with the contracts. At this point in time we don't see any change of that.

(Jean Bruny): OK, thank you very much.

Operator: And there are no questions at this time. I will turn the call over to Mr. Freyre for the closing remarks.

Francisco Freyre: Thank you again for joining us on the call today. If you have any outstanding questions, please don't hesitate to reach out to me or to anyone on the team and we look forward to speaking with you within the next three months and we wish you a good day.

Operator: And this concludes today's conference call. Thank you for your participation, you may now disconnect.

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