

Rassini Earnings Conference Call for the First Quarter of 2018

Moderator: Emma Bocanegra
April 24, 2018
10:00 a.m. ET

Operator: This is conference # 3673804.

Operator: Good morning, and welcome to Rassini's Earnings Conference Call for the First Quarter of 2018.

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 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 Ms. Emma Bocanegra, Head of Financial Planning and Investor Relations. Please go ahead.

Emma Bocanegra Fragoso: Thank you, operator, and good morning, everyone. Thank you for joining us on the call, as we discuss our results for the first three months of 2018. With me on the call today is Juan Pablo Sánchez, our CFO.

I would like to begin by sharing some highlights from the quarter, which we will describe in more detail throughout our presentation.

Sales in the first quarter saw a slight decline of 3% year-over-year to MXN4.7 billion. Consolidated EBITDA was MXN923 million, which represent an 8% decrease compared to the same period in 2017. Our net income was flat on a percentage basis compared to the first quarter of 2017 at MXN456 million or the equivalent to MXN1.43 per share.

These results are primarily due to the completion of the temporary extraordinary contract that was previously disclosed and the impact of the peso appreciation against the U.S. dollar. Excluding this temporary extraordinary contract and the effect of the peso revaluation, 2018 first quarter consolidated sales would have shown an increase of 8% and EBITDA would have been 5% higher compared to the same period in 2017.

We are pleased with this progress, which is a result of an increase in demand for our products, market share gains for brake and suspension components, and the commencement of production related to new contracts awarded in prior years.

Turning now to slide four for a brief industry update. As demonstrated by this slide, macroeconomic conditions continue to be positive in North America. Unemployment continues to decline, fuel cost remain relatively low, and U.S. housing starts have now exceeded 1 million homes for 35 consecutive months.

The U.S. auto sector achieved solid performance this quarter. The Seasonally Adjusted Annualized Rate, or SAAR, of U.S. light vehicles reached 17.4 million vehicles in March, which represents the strongest performance during the month of March in 17 years. Inventories were equal for approximately 68 days' supply and down from 72 days' supply during the same period last year.

While total North American light vehicle production was 4.4 million during the first quarter of 2018, down approximately 3% compared to the same period last year, the production of light trucks actually increased 4% year-over-year. The light truck segment represents the most profitable market for OEMs. The mix of light vehicle production in North America also continues to shift due to changing consumer preference.

Looking forward, IHS experts currently estimate that the total production of light vehicles in North America will reach 17.3 million units in 2018, a 1% increase compared to the end of 2017 and 17.4 million units in 2020.

Turning to slide six, our Brazilian business continued its recovery and comprised 12% of consolidated sales during the first quarter of 2018 versus

9% during the same period last year. We saw 15% growth in total vehicle production, which notably included 58% growth in the production of heavy trucks and buses, our main market in the region.

Looking ahead, Sindipeças expects production to increase 13% by the end of 2018 compared to 2017, and is forecasting approximately 5% annual growth thereafter through 2022.

Moving on to our financial highlights and results beginning on slide eight, we reported a slight decline year-over-year to both consolidated sales and EBITDA, due to the completion of the temporary extraordinary contract and the impact of the peso appreciation against the U.S. dollar.

Slide nine shows our sales and EBITDA broken out by region. In NAFTA, sales decreased 6% and EBITDA declined 13% during the first quarter of 2018 year-over-year. However, in Brazil, sales for the first quarter of 2018 rose 34% in terms of Mexican pesos, which is equal to a 48% increase in the local currency and a 44% increase in terms of volume compared to the same period the previous year. This growth also supported an improvement in operations and cost control and resulted in an EBITDA of MXN61 million, which represents a nearly 400% increase compared to the same period in 2017.

Turning to slide ten, which details sales by product mix segment and region. The reduction in total NAFTA sales was driven by the completion of the temporary extraordinary contract and the readjustment in North America light vehicle production but was partially offset by the increase in new contracts within the Brakes Division. These aforementioned factors contributed to a 12% decrease in the Suspensions Division and 5% growth in the Brakes Division compared to the same period in 2017.

As shown on the slide 11, our consolidated income before taxes and minority interest was MXN590 million, a 1% decrease compared to the first three months of 2017. We also reported MXN456 million of consolidated net income, which is approximately flat to the MXN457 million of net income from the same period last year.

Moving on to slide 12. Net operating cash flow decreased MXN372 million, mainly due to lower EBITDA and the increase in taxes paid during the first quarter of 2018 as a result of the fact that from 2016 to 2017, almost all tax losses were applied. Our ending cash balance as of March 31, 2018, was MXN1.8 billion or \$100 million.

In addition, as part of our ongoing commitment to deliver value to our shareholders, next week on May 3rd, we will pay dividends equal to MXN800 million, which is equivalent to MXN2.50 per share and represents a dividend yield of 6%.

As you can see on slide 13, our consolidated net debt balance decreased by half to US\$21 million as of the end of the first quarter, down from US\$42 million as of the same period last year. The cash balance as of March 31, 2018, was US\$100 million.

Turning now to our financial ratios that remain healthy as detailed on slide 14. Our leverage ratio as of March 31, 2018, was 0.1x net debt to EBITDA, while the interest coverage ratio was 13.5x EBITDA to net interest expense.

In closing, I would like to reiterate that while some of uncertainties in 2018 remain, we are pleased with how our company has responded to these challenges and we are proud of our overall performance this quarter. We remain optimistic as we look ahead to the remainder of the year, especially as we begin working on contracts awarded in previous years in the second half of 2018, including platform replacements and new business in North America. These contracts reflect the determination of our team and the continued trust our customer place in our technological excellence, unparalleled product quality and impeccable service. As a result, combined with expansion in our range of products and the use of new materials that will improve the performance of automotive vehicles, we see a myriad of opportunities moving forward.

With that, our team would be happy to open the call for questions. Operator, you may now open the line.

Operator: Thank you. To ask a question during this time simply press star then the number one on your telephone keypad. That's star one to ask a question. If you would like to withdraw your question press the pound key. We'll pause for just a moment to compile the Q&A roster.

And your first question comes from the line of Mauricio Serna from UBS.

Mauricio Serna Vega: I guess, I just had one question regarding the volumes in NAFTA. Looking at the leaf springs volume, you mentioned there was a 5% decline in the Suspensions Division.

And I just wanted you to help us reconcile maybe – because I was doing the analysis of how much the leaf springs volumes on a recurring basis have declined, and I got to a number of around 4%, slightly below that, 4% decline when the light trucks production is growing 4% as of March.

So just wanted to understand what's going on there. You did mention that there is some adjustment in the production from the OEMs, but I just want to get a better understanding on what has been the driver for that recurring volume decline, if that is a correct estimate to you?

Juan Pablo Sánchez: OK. Thank you for your question, Mauricio. Yes, as you mentioned, if we take out this extraordinary contract, we have a decreasing volume in the leaf springs. This decrease has its explanation. Last year, first quarter 2017 was a stronger quarter in production.

Maybe you remember that last year, the beginning of the year, General Motors mainly was doing a very, very good level of production. After that period, they have to level the inventories. There was an issue with inventories.

This issue with inventories was in preparation because in the second half of 2017, there would be the launching of the new platforms. Then first quarter – second quarter 2017, General Motors prepared for the launching of the second half of that year. And that's one part of the explanation.

Second part, we are thinking that this is a kind of seasonality because based on orders released by our customers, at this point in time, we are expecting

that the second quarter of 2018 will be 4% higher versus the previous year the same semester. Then we can say that it was a production strategy of mainly General Motors based on the strategy that they followed last year.

Mauricio Serna Vega: OK, OK. So – just so – I'm sure I get this right, it seems more like it's a theme about your customers, your main customers. Your OEMs maybe reducing the production rather than – when you look at the headline 4% industry number.

So – I mean, just want to make sure there wasn't any market share losses implied. And just very briefly on your second point, this means that you are guiding for a second quarter volume in leaf springs to rise 4%, if I'm not mistaken?

Juan Pablo Sánchez: Yes, you are right. And let me tell you that based on our strong market share, if there is, let's say, reduction in the production of 1 customer and the increase in the customer because of very strong market share, we will capture that. And also let me – it's more of an – let's say, this is more focused in General Motors. And it is more focused because last year, it wasn't a stronger year in the case of General Motors.

Mainly at the beginning of the year, they increased the production because they were preparing inventories to attend the launching on new platforms for the second half of 2017. That makes that the first and the second quarter were very strong for – mainly for General Motors.

Mauricio Serna Vega: OK. OK, great. And finally, this second quarter you will still have a negative effect from the tough comps from the extraordinary contract, right, if I'm not mistaken?

Juan Pablo Sánchez: Yes. We have something about the expectation of the 4%, as I already mentioned, is taking of that extraordinary contract.

Mauricio Serna Vega: It's taken into account, already?

Juan Pablo Sánchez: No, taking out.

Operator: And your next question comes from the line of Guillermo Diego from Santander.

Guillermo Diego Delgadillo: Just wondering could you give us your outlook for the margin of the rest of the year, not on the consolidated basis, not only the short term of the quarter but the whole year, please?

Juan Pablo Sánchez: Yes. As we mentioned in our past conference call, we are expecting this year with the same margins, more or less, the one that we have in 2017. We are expecting in a range of 18% to 19%.

Operator: Your next question comes from the line of Alejandro Azar from GBM.

Alejandro Azar Wabi: My first question is a follow-up on the leaf springs division, on the volumes decline 5%. If you could give us some color on the inventory levels of the pickup truck market. You mentioned that inventories in the market are around 68 days. I don't know if you can share with us that figure.

Juan Pablo Sánchez: Yes. The inventories level in the – for the pickup is in a 72, 74 days. And it's a – we can say that this is stable – it's stable.

Alejandro Azar Wabi: Perfect. And my second question is regarding the Brazilian operations. Mainly due to the strong growth that we've seen during the past year and the restructure that you made 2 or 3 years ago on the business, what could you mention about a normalized margin going forward? Should we expect higher than 12%, 13%? Or what do you see going forward in this division?

Juan Pablo Sánchez: Yes. We – based on the information that we have on our hands and considering the volume expected, we think that the margin of the Brazilian operations would be in the range of 12% to 13%.

Alejandro Azar Wabi: OK. Wonderful, Juan Pablo. And one more, if I may. You mentioned that you had extraordinary cash tax payments during the quarter. Are these levels should be a normalized level? I couldn't quite understand that you mentioned that during the past years you had tax losses...

Juan Pablo Sánchez: Yes. 2016, we used almost all our tax losses. And as you know, when we calculate the advance payments for the annual tax, we must take into consideration these tax losses. The payment that we made last year, first quarter last year, let's say the payment of December we made our payment in January was impacted by the tax losses because we can't use that until we present the tax return.

This year, because we don't have these tax losses, in the first quarter of 2018, we have, let's say, high advance tax payment corresponding to December that we made in January 2018. Our expectation is to have, more or less, the same level of tax payment that we have in the, let's say, second, third and fourth quarter of 2017. We are expecting, more or less, the same level for the rest of the year of 2018.

Alejandro Azar Wabi: OK. Juan Pablo, that was my question because the level I'm seeing for the first quarter is around MXN300 million, and last year, the whole year was around MXN750 million. So that – but the answer is – it's perfect for me.

Operator: And your next question comes from the line of Alejandro Manzo from Actinver.

Alejandro Manzo: Just 2 quick questions. Regarding coil springs, we saw very important decline in volume. I'm – if I'm not mistaken, 11.2% – I'm sorry, 16.4% year-over-year. So, I just wanted to understand that wasn't driven in revenue, (inaudible).

So, I would like to get some insight on whether or not we could expect these levels of decline going forward. Because as I understand it, the sedan to trucks decision is more or less over or it's not going as forward as it was going previously. So, if you could provide a little bit more insight into that? And the second question regarding energy cost.

You had a very strong margin in the first quarter of '18, 19.4% margin. And I just wanted to get some insight of whether or not you would expect perhaps a slight decline in margins in the rest of the year as prices are – energy cost adjusts or even rise a unit.

As I understand it, it's something that some analysts expect to happen in the second half of the year. So, what's your point of view in these 2 subjects?

Juan Pablo Sánchez: OK. Alejandro, first your question on coil springs. Coil springs, as you know is, let's say, an important part of the production of the coil springs devoted to the passenger cars. Because in the market, there is a shift in the consumer preference from passenger cars to light trucks that has been impacted the volume in the coil springs. And we can say, for the rest of the year, the volume of coil springs will be around the same that we have in this first quarter.

Second, talking about energy, energy reflect a reduction if we compare the cost of the energy of this first quarter 2018 against first quarter 2017. You know every month the alternative pool is the – the tariffs that will be applying monthly. This, at the end of last year, there was a significant increase in the cost of energy. And however, this first quarter, we see a reduction.

For the rest of the year, we are expecting, let's say, that the cost of the energy will be remaining in the level that we have in first quarter '18. This is our expectation, but we need to see the tariff established by the authorities. They always mention that the calculation of the tariff is waste. They are observing the most efficient cost of production of energy. However, every month, we can face changes on that.

Operator: And your next question comes from the line of Jean Bruny from Banco BBVA.

Jean Bruny: I just have one question left. I reckon it's on the CapEx. If you can take this on the CapEx, you mentioned at the beginning of the year that you will be investing between MXN20 million to MXN30 million for the new plants or the new line. Can you give us some updates how the investment is going on? And what do you expect for the remaining of the year?

Juan Pablo Sánchez: Yes. As we mentioned last call, we are expecting CapEx in the – around MXN30 million that includes the composite line and the CapEx for new materials and productivity improvements. We are – let's say, we are in line with that. We are spending according with the program.

We have to follow that because customers are reviewing the advances that we have in the building of this new facility because we need to be ready for launching prototypes, etcetera, by the next year. And we don't have any issue at this point in time, and we are on line with the comment that we did in our last conference call.

Operator: And again, to ask a question during this time simply press star then the number one on your telephone keypad. That's star one to ask a question.

And we have another question from the line of Guillermo Diego from Santander.

Guillermo Diego Delgadillo: Just to clarify, what's going to be the CapEx for this year? And how much is going to be maintenance? Because last time, you said there were going to be around MXN60 million. MXN10 million of those was going to be maintenance?

Juan Pablo Sánchez: Yes, Guillermo, the total, as you mentioned is MXN60 million. MXN30 million out of this MXN60 million is maintenance CapEx and the other MXN30 million are for the composite line and new materials.

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

Juan Pablo Sánchez: OK.

Operator: At this time, I'll turn the call over to the panelist for the final remarks.

Emma Bocanegra Fragoso: Thank you, everyone. We will be ready and continue on the next call for the results of the second quarter of 2018. Thank you.

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

END