Rassini Earnings Conference Call for the Second Quarter of 2018
Moderator: Emma Bocanegra
July 25, 2018
10:00 a.m. ET

OPERATOR: This is conference # 4398348

Operator: Good morning, and welcome to Rassini's Earnings Conference Call for the second quarter and first half of 2018. At this time, all participants are in 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: 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 2018. With me on the call is Juan Pablo Sánchez, our CFO.

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

Consolidated sales in the first half saw a slight increase of 1% year-over-year to MXN9.5 billion. In the second quarter alone, we reported a 6% increase in sales or MXN4.7 billion compared to the same period last year. EBITDA was

MXN1.8 billion for the six months ending June 30, 2018, which represented a 3% decrease compared to the same period in 2017. These results were primarily due to the completion of the temporary extraordinary contract that has been discussed over the past few quarters and the continued impact of the peso appreciation against the U.S. dollar.

Excluding this temporary extraordinary contract and the effect of the peso revaluation, 2018 first half consolidated sales would have shown an increase of 5% and EBITDA would have been 1% higher compared to the same period in 2017.

The EBITDA margin for the first half of 2018 was 18.8%. We are pleased with these results, which demonstrated an increase in demand for our products, market share gains for brake components, the ongoing recovery of the Brazilian automotive sector and the commencement of production related to new contract awarded in previous years.

Net income was MXN816 million or MXN2.55 per share, which represented a 7% decrease due to an increase in tax paid due to the fact that nearly all the tax loss carryforwards were applied in 2016 and 2017, and the effects in the minority interest due to the improvement in net income in our Brazilian Division.

We maintain an optimistic outlook on the financial performance of our business. And, as Rassini continues to deliver a strong financial performance, we remain committed to creating value for our shareholders as evidenced by the MXN800 million dividend paid in May 2018.

We are also pleased that over the years, Rassini has played an increasingly larger role in the global automotive ecosystem. Rassini is dedicated to the development of technology and the innovation of products and processes to meet the preferences and demands of our customers. Rassini continues to successfully provide solutions that improve the efficiency of operation in new platforms, including weight reduction actions in suspensions with the same or better performance relating to the comfort and life of products.

For example, the investment in a new composite plant of suspensions has a 50% advance installation that will allow for state-of-the-art technology in automation, control of processes and allow us to incorporate the current trend of automation and data exchange in manufacturing technologies, as well as the use of new lightweight materials. It will also give us the ability to produce in our facilities using the best technology. Investments like these allow Rassini to better serve our customers and enables us to assist the integration and improvement of current processes and participate in innovation forums that are organized annually by our customers and are typically only available by direct invitation that is sent to less than 1% of the supplier base.

Also of note this quarter, in May, the Texas Secretary of State, Rolando Pablos, presented Rassini's CEO Eugenio Madero with a humanitarian award for the relief Rassini sent last September to the victims of Hurricane Harvey. Secretary Pablos acknowledged the solidarity and commitment shown by Rassini to the residents of Texas during the cleanup after the storm and gave the company this award as a token of his appreciation. Rassini was proud to have been able to contribute to communities not only in Texas, but in Puebla, Oaxaca, Chiapas, and Mexico City following the devastating natural disasters that occurred last year, and to have had the opportunity to assist in the recovery efforts and support the communities in which we operate during their time of need.

We take great pride in caring for our employees. We are honored to have once again received the designation of Great Place to Work for the third consecutive year, which demonstrates that Rassini is fostering a safe, entrepreneurial, and rewarding environment for our employees so that they feel valued and motivated to contribute to the growth and overall culture of the company.

Turning now to Slide four for a brief industry update. Macroeconomic conditions as of June 2018 remained positive in North America: unemployment continued to decline, fuel costs were relatively low by historical standards, and U.S. housing starts exceeded one million homes for the 39th consecutive month.

The U.S. auto sector again saw solid performance this quarter. The Seasonally Adjusted Annualized Rate or SAAR of U.S. light vehicles reached 17.5 million units during June 2018, 7% higher than the June 2017 SAAR of 16.4 million units. Inventories were equal to approximately 68 days of supply, down from 74 days of supply during the same period last year.

While total North American light vehicle production was 8.8 million units, which represented an approximately 3% decrease compared to the first half of last year, the production of Light Trucks actually increased 5% year-over-year and the Light Trucks segment remains the most profitable market for OEMs. The mix of light vehicle production in North America also continued to shift due to changing customer preferences. For the six months ending June 2018, the mix was comprised of 69% Light Trucks to 31% Passenger Cars, compared to the first half of 2017 when the mix was 64% Light Trucks to 36% Passenger Cars.

Turning now to Slide six. Our Brazilian business continued its recovery and comprised 11% of consolidated sales during the first half of 2018, versus 9% during the same period last year. We also saw 14% growth in total vehicle production which notably included 38% and 50% growth in the production of heavy trucks and buses respectively, our main markets in the region, and vehicle exportation experienced 1% growth during the first six months of 2018 compared to the first half of 2017. Looking ahead, Sindipeças expects full-year 2018 production to be 12% higher than 2017 and continues to forecast approximately 5% annual growth thereafter through 2022.

During the second quarter, Rassini continued to reinforce our Brazil team and work actively towards adjusting our operations to better align with our structure so that we are positioned to take full advantage of the opportunities we expect to arise as a result of the ongoing economic recovery in the country.

Moving on to our financial highlights and results beginning on Slide eight. We reported a slight increase in consolidated sales year-over-year, but a small decrease in EBITDA due to the completion of the temporary extraordinary contract in mid-2017 and the impact of the peso appreciation against the U.S. dollar.

Slide nine provides additional detail and breaks down our sales and EBITDA by region. Consolidated sales remained robust in the first half of 2018 and reported MXN9.5 billion or a 1% increase, year-over-year. In NAFTA, sales experienced a slight 1% decrease and EBITDA declined 7% during the first six months of 2018, year-over-year. However, in Brazil, sales for the first half of 2018 rose 24% in Mexican pesos, which was equal to a 35% increase in the local currency and a 32% increase in volume compared to the same period the previous year. This growth was also supported by an improvement in operations and cost control and resulted in an EBITDA of MXN112 million, which represented a 160% increase compared to the same period in 2017, including the negative effects caused in May 2018 by the strike of transporters.

Turning to Slide ten, which details sales by product mix segment and region. The reduction in total NAFTA sales was driven by a 6% decrease in the Suspensions Division during the first half of 2018, but was partially offset by 9% growth in the Brakes Division, compared to the same period in 2017. This growth in the Brakes Division was supported by the launch of new contracts while the decrease in the Suspensions Division was due to the completion of extraordinary contract, the phase in-phase out of the K2XX GM platform that will be replaced during the second half of 2018 with the new model, the halt in the F-Series production during May, and the end of the lifecycle of some platforms like the Nissan Tsuru.

As shown on Slide 11, our consolidated net income before taxes and minority interest for the second half of 2018 was MXN1.1 billion, which represented a slight 2% decrease compared to the same period the previous year. We also reported MXN816 million of consolidated net income for the six months ending June 30, 2018, a 7% decrease from MXN876 million of net income during the first half of 2017, as a result of an increase in taxes due to the fact that nearly all the tax loss carryforwards were applied in 2016 and 2017, as well as the effects in the minority interest due to the improvement in net income in our Brazilian Division.

Moving on to Slide 12. Net operating cash flow decreased 11% year-over-year from MXN1.4 billion to MXN1.2 billion in the first half of 2018, mainly due to lower EBITDA and the increase in taxes paid during the first six months of the year as a result of the fact that the tax loss carryforwards were applied in previous years. Our ending cash balance as of June 30, 2018, was MXN1.1 billion, which was equivalent to $54 million USD.

As you can see on Slide 13, our consolidated net debt balance increased to $51 million USD as of the end of the second quarter, up from $29 million USD as of the same period last year due to the MXN800 million dividend payment made in May 2018. However, total debt decreased over this time period from $146.5 million USD to $104.2 million USD.

Turning to our financial ratios on Slide 14, which remain healthy. Our consolidated leverage ratio as of June 30, 2018 was 0.3x net debt to EBITDA, while the interest coverage ratio was equal to 12.8x EBITDA to net interest expenses.

In closing, I would like to reiterate that we are pleased with what we have accomplished during the first half of this year. We continue to remain optimistic as we look toward the balance of the year, particularly as we begin working on previously awarded contracts in the second half of 2018, including platform replacements and new business in North America. These contracts reflect our ongoing commitment to innovation and technological expertise, the determination of our team, and the continued trust our customers place in our technological excellence, unparalleled product quality and impeccable service.

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

Operator: At this time, if you would like to ask a question, please press star, then the number one on your telephone keypad; star one to ask a question. And your first question comes from the line of Mauricio Serna from UBS.

Mauricio Serna: I guess I just want to talk about what are your expectations for the second half of this year as you finish cycling in the tough comps due to the extraordinary contract? Do you – should we look forward to more positive volumes in the

Suspension Division? And does the second quarter, how does that change your outlook on guidance in terms of sales and EBITDA for the year?

And, I mean, most importantly also on the cost, maybe you can elaborate a little bit more on the costs affecting Mexico, in the NAFTA Division in the second quarter. I think there was probably some headwinds on the energy front. Is there anything that is being done by the company? And lastly, just in the medium term, do you see any risks with the revisions that are being discussed in Section 232 on the auto parts that could hamper or damage the dynamics of the industry? And how do you see that potential risk?

Juan Sanchez: OK. Thank you, Mauricio. Talking about your first question regarding how we are seeing volume for the second half. First of all, we need to explain that in this second quarter, we have some factors that affected our (various) sales volume. One was in the NAFTA Suspension Division regarding the problem that suffered for, this customer stopped production of the Series F for 1.5 weeks and that also effected the volume. The second event that we had during this second quarter was the strike of drivers in Brazil. As a result, we stopped selling for 15 days and the whole country, Brazil was stopped by this. For the second half, we are replacing the new platform in the case of the pickups for GM. We are expecting the launching of the new platform by the second half of 2018.

Based on these factors, we are thinking that the NAFTA Suspension Division will have, let's say, a volume, sales volume, more or less in line with last year’s, or 1% or 2% below the volume that we had last year. With respect to the Brakes business, we are expecting the volume. We can confirm our guidance of 5% to 7%. It's important to mention that building this new platform for GM, the one that we will be starting in the second half, the Brakes business will be supplying not only the rear disc, but also the front disc, so that will increase. Obviously, all of these numbers could change depending on the success of the launch of the platform for GM.

The second question, with respect to affecting the second quarter about cost, one part of this affecting in the second quarter was related to the issue that we had to stop selling, for about 1.5 weeks, products for the Series F. Because of that, you cannot adjust immediately all of the operations. And, we were expecting that after the recovery of the customer – recovery, the sales of this customer, we had to deliver.

Because of that, we have some issues about, let's say, productivity. And the second part was also the effects of the exchange rate that we discussed in the past.

Talking about the third point that you mentioned, Section 232. Last week, there were several hearings in Washington, D.C. where many stakeholders presented arguments in favor of, and against, this section— all the OEMs, all the associations, the Mexican government, etc. — each presented arguments saying that this Section 232, in respect to auto and auto parts, is not against national security. They explained with several comments and numbers that, based on this kind of tariff, it could affect the U.S. economy and, obviously, employment in the United States. That is the information we have. We need to wait for the results and the final evaluation of the comments, and the timing in the United States, to see what the outcome will be.

Mauricio Serna: OK. Just quickly on the first question, you talked about the volumes but do you have a guidance for the EBITDA, or in terms of maybe margins, or just EBITDA itself? And lastly, just in the Section 232, if it were to be implemented, if there's a negative outcome, and if implemented, would Rassini be passing down any of this additional cost from the imports to the OEMs? How would the company work with that? I guess that's the question.

Juan Sanchez: OK. First, talking about margins, we can confirm that we are expecting to be in the range of 18% to 19% — we mentioned this in our conference call when we discussed the results of 2017. With respect to the tariffs — pardon me?

Mauricio Serna: I'm sorry, the consolidated margins, right?

Juan Sanchez: Yes, yes, consolidated, yes. And the schedule, your question about tariffs. At this point in time, there are no discussions or negotiations or any exchange of information with the OEMs. As soon as we have something, we will let you know. OK.

Operator: Next question is from Guillermo Diego from Santander.

Guillermo Diego: OK. My question is on working capital, is the increase that we saw in days of accounts payable to 70 days sustainable? Or should it go back to 60 days where we had seen it in the past when you had the change in Brazil financing?

Juan Sanchez: Yes. The answer is we will be in this range of 62 to 70 days. Sometimes some of the suppliers, we have to negotiate and change the terms and conditions sometimes, but this is the standard range for the company.

Guillermo Diego: OK. And in CapEx, are we expecting the MXN60 million for this year including the composite facility? And what would be the CapEx for next year?

Juan Sanchez: Yes. For this year, we are expecting the same, the MXN60 million that you mentioned. We confirmed this CapEx when we talked about that in the past conference call. We mentioned that the MXN30 million is for maintenance, MXN15 million is for the composite line, and MXN15 million is for the new materials and productivity improvements. We don't see an increase on this CapEx at this point in time.

Guillermo Diego: And just maybe finally, can you give us your outlook on Brazil, the improvement in volume that we saw? How sustainable is it or should we expect a better performance towards the next quarters?

Juan Sanchez: Yes. For the Brazilian operations, we have to remember that the first quarter of 2017 was a very, very low quarter. The recovery of the auto sector started—we can say during, more strongly during August—July, August and September. We are expecting to maintain this line, the production that we faced during the last months, but we need to be very careful, since, also in the second half of this year, Brazil will be have presidential elections, and this can create some uncertainty and some issues that can, let's say, stop this recovery. But with the information we have, we can say that we will be in the same level that we have been facing in the last months.

Guillermo Diego: OK, so the best case is 12,000 tons now for the rest of the year?

Juan Sanchez: Pardon me? I can't hear you. Sorry.

Guillermo Diego: So the best case is to keep the production around 12,000 tons for the rest of the year?

Juan Sanchez: Yes.

Operator: Once again, star one to ask a question; star one if you'd like to ask a question. There are no further questions at this time. Ms. Emma, please, do you have further remarks?

Emma Bocanegra: Thank you, operator. Thank you again for joining us on the call today. If you have any remaining questions, please don't hesitate to reach out to me or anyone else on the team. We look forward to speaking to you over the next three months and we wish you a good day. Thank you.

Operator: Thank you again for joining us today. This concludes today's conference. You may now disconnect.

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