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Moderator: Berenice Muñoz Jalpa
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Operator: This is Conference # 5790236

Operator: Good morning and welcome to Rassini’s Earnings Conference Call for the Third Quarter and first nine months 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 call 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 Web Site 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 would now like to turn the call over to Berenice Muñoz Jalpa, who joined the Rassini team in August as the FP&A Manager. Please go ahead.

Berenice Muñoz Jalpa: Thank you, Operator. Good morning, everyone. Thank you for joining us on the call as we discuss our results for the third quarter and first nine months of 2018. With me on the call today is Juan Pablo Sanchez, our CFO.

I would like to begin by sharing some highlights from the quarter and the first nine months of 2018, many of which we will describe in more detail throughout our presentation. Unless specified to the contrary, all numbers are in Mexican pesos.

Consolidated sales for the first nine months of 2018 saw a 5% increase year-over-year to MXN 14.2 billion. In the third quarter alone, we reported a 13% increase in sales compared to the same period last year, or nearly MXN 4.8 billion. EBITDA was MXN 2.5 billion for the first nine months ending September 30, 2018, which represented a slight MXN 6 million increase compared to the same period in 2017. We are very pleased with these results, which were primarily driven by market share gains for brake components, the ongoing recovery of Brazilian auto sector and the commitment of production in new contracts awarded in previous years.

The EBITDA margin for the first nine months of 2018 was 17.8 as a percentage of sales or 80 basis points lower than the same period last year. This decrease was mainly due to the end of the extraordinary contract as previously discussed, increases in energy prices and the phaseout of some platforms that are being replaced during the second half of 2018 with a newer model.

Consolidated net income for the first nine months ending September 30, 2018, was MXN 1.1 billion or MXN 3.54 per share, which represented a 6% decrease due to (i) a lower benefit in deferred taxes as a result on the fact that the tax loss carryforwards were applied in 2016 and 2017 and (ii) the effects of the minority interest due to the improvement in net income in our Brazilian division.

Of particular note this quarter, in August, Fitch Ratings upgraded Rassini's long-term corporate credit rating from BB- to BB with a stable outlook. In this report, the ratings agency cited Rassini's continued repayment of existing bank debt, which combined with the already awarded contracts for new models of all major pickup platforms, contributed to their belief that Rassini will be able to generate solid cash flow and gain additional leverage headroom.

In addition, in September, Rassini's Chairman and founder, Antonio Madero Bracho, was recognized at The Foro Forbes 2018 event in Mexico City, where he was presented with the 2018 Business Excellence Award. Rassini was very pleased to accept this award, which recognized our tremendous growth over the last 30 years and our complete transformation from a small vehicle parts manufacturer to a multinational and technologically dedicated company with almost $1 billion in annual revenue.

Separately, Rassini continues to actively monitor developments surrounding the United States-Mexico-Canada agreement. This new agreement will allow Rassini to better plan for the future and maintain competitiveness in its key markets.

Turning now to Slide 4 for a brief industry update. Macroeconomic conditions as of September 2018 continued to track positively in North America. Unemployment continues at low levels; fuel costs remain relatively low by historical standards and U.S. housing starts exceeded 1 million homes for the 42nd consecutive month.

As demonstrated on Slide 5, the U.S. auto sector again saw solid performance this quarter. The Seasonally Adjusted Annualized Rate, or SAAR, of U.S. light vehicles was 17.4 million units during September 2018, just below the highest monthly SAAR in 2018 that occurred in June at 17.5 million units. Please note that September 2018 SAAR is below the 18.5 million units that was achieved in the same period last year due to the impact that Hurricane Harvey had on replacement demand, which significantly boosted last year's sales figures and, therefore, makes for an incomparable comparison. Inventories were equal to approximately 65 days of supply, just slightly above the 64 days of supply achieved during September 2017.

While North America light vehicle production totaled 12.8 million units during the first nine months of 2018, a 2% decrease compared to the same period last year, the production of light trucks actually increased 5% year-over-year and the light truck segment remains the most profitable market for OEMs.

For the nine months ending September 30, 2018, the mix was comprised of 69% light trucks to 31% passenger cars compared to the first 3 quarters in 2017 when the mix was 65% light trucks to 35% passenger cars. IHS forecasts production in North America will reach 17.1 million units by the end of 2018, the same level compared to end of 2017, and a period of stability is expected over the following years.

Please note that the small decrease in production that is predicted in the year 2020 is mainly due to the replacement of the new F-series platform. However, production is expected to recover thereafter as demonstrated by the estimate that production will reach 17.3 million units in 2021 and 17.7 units in 2023.

Turning to the Slide 6, our Brazilian business continued its recovery and comprised 11% of consolidated sales during the first 3 quarters in 2018, versus 10% during the same period last year. We also saw 11% growth in total vehicle production, which notably included 31% and 43% growth in the production of heavy trucks and buses, respectively, which are our main markets in the region.

Looking ahead, Sindipeças expects total year-end 2018 production to equal 3 million vehicles, an 11% increase versus 2017 and continues to forecast approximately 5% annual growth thereafter throughout 2022.

Moving on to our financial highlights and results beginning in the Slide 8. We reported a 5% increase in consolidated sales year-over-year in part due to the market share gains for brake components, the ongoing recovery of the Brazilian auto sector, and the start of production on new contracts awarded in previous years, but a relatively flat EBITDA mainly driven by the end of the temporary extraordinary contracts, increases in energy prices and the phaseout of some platforms that are being replaced during the second half of 2018 with a newer model. However, the negative EBITDA impacts were partially offset by an increase in EBITDA in the Brazilian division as demonstrated on the following slide.

Slide 9 provides additional detail and breaks down our sales and EBITDA by region. Consolidated sales remain strong during the first nine months of 2018 with a reported MXN 14.2 billion or a 5% increase year-over-year. In the NAFTA region, sales experienced a 4% increase, whilst EBITDA declined 3% during the first 3 quarters of 2018 year-over-year.

However, in Brazil, sales for the first nine months ending September 30, 2018, rose 13% in Mexican pesos, which was equal to a 26% increase in the local currency and a 21% 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 EBITDA of MXN 161 million, a 74% increase compared to the same period in 2017. This includes the negative effects in May 2018 caused by the strike of transporters and the impact of the Brazilian real's devaluation against the U.S. dollar.

Turning to Slide 10, which details sales by product mix segment and region. The 4% increase in total NAFTA sales was driven by 13% growth in the Brakes Division compared to the same period in 2017, which was partially offset by the 1% decrease in Suspensions Division during the 3 quarters ending September 30, 2018. This growth in the Brakes Division was supported by the launch of new business contracts, while the decrease in the Suspension Division was due to a completion of the extraordinary contract, the phaseout of the K2XX GM platform that is being replaced during the second half of 2018 with a newer model, a halt in the F-series production during May, and the end of the life cycle of some platforms like the Nissan Tsuru.

As shown in Slide 11, our consolidated net income before taxes and minority interest for the first nine months of 2018 was nearly MXN 1.6 billion, which represented a 6% increase compared to the same period from last year. We also reported MXN 1.1 billion of consolidated net income for the first nine months ending September 2018, a 6% decrease from the MXN 1.2 billion of net income reported in the first nine months of 2017 due to, (i) a lower benefit in deferred taxes as a result of the fact that the tax loss carryforwards were applied were applied in 2016 and 2017, and (ii) the effects of the minority interest due to the improvement in net income in our Brazilian division.

Moving on to Slide 12. Net operating cash flow decreased 10% year-over-year from approximately 1.8 to 1.6 billion for the 3 quarters ending September 30, 2018, mainly due to the increase in taxes paid during the first nine months of the year as a result of the fact that nearly all tax loss carryforwards were applied in previous years. Our ending cash balance as of September 30, was approximately MXN 1 billion, which was equivalent to US$55 million.

As you can see on Slide 13, our consolidated net debt balance decreased significantly from MXN 57 million to MXN 41 million as of the end of the third quarter year-over-year. In addition, total debt decreased over this time period from $134.4 million to $95.5 million.

Turning to our financial ratios on Slide 14, which remains healthy. Our consolidated leverage ratio as of September 30, 2018, was 0.2x net debt to EBITDA while the interest coverage ratio was equal to 12.6x EBITDA to net interest expenses.

In closing, I would like to reiterate that we continue to be pleased with our accomplishments during the first nine months of the year and we remain optimistic about the balance of the fiscal year, particularly given that we have commenced work on previously awarded contracts. These contracts reflect our customers' recognition of Rassini's ongoing commitment to innovation and technological expertise, unparalleled product quality and impeccable service in addition to the overall determination of our team.

With that, we would be happy to open the call for questions. Operator, please open the lines.

Operator: Thank you. To ask a question during this time, please press the number "one" and "star" on your touch-tone telephone. That's "star" then the "one" to ask a question. If you'd like to withdraw your question, please press the "pound" key. We'll pause for a moment to compile the Q&A roster.

And our first question comes from Mauricio Serna with UBS. Your line is now open.

Mauricio Serna Vega: Hi. Good morning. Congratulations on the results and thanks for taking my questions. Just a couple of questions.

We've seen throughout this year, the -- I guess, the improving mix or the mix shifting more and more into light trucks now versus the passenger cars now at 69 and 31 as you pointed out. Do you think that's a sustainable level given the rising energy costs?

And I guess, on the other hand, if you could provide us maybe a little bit more details on the current composite plant project -- how's that coming along? I mean, when do you expect to see it contributing to the operations and especially, too, I guess to the margins of the company?

And finally, how should we think about the cash taxes? As you mentioned, you paid more taxes as you exercise the tax loss carryforwards from previous years. So I mean, how should we think about it for in the coming years? Thank you.

Juan Pablo Sanchez Kanter: OK. Thank you, Mauricio.

First answer is related to the shift between light trucks and passenger cars. That -- as you see right now, light trucks are representing almost 70% and passenger cars, 30%. Based on projections, the major OEMs are thinking that this shift is here to stay for a long period of time. They in -- for example, in the case of Ford, they are moving their strategy from passenger cars to light truck SUVs because this market is a profitable market for the OEMs.

Second, with respect to energy costs, as you see, compared to the last year, we have suffered an increase in the tariffs of around 85%. The company is looking for producers of energy, taking advantage of the energy reform. And in the future, maybe we will be having some power purchase agreement that we will have for 5 to 8 years. We are looking for the best option for the company in order to offset these energy costs.

Second, the composite plant. As you know, the composite plant is a facility that will take us around 2 years to build, this and next year. And we will be expecting to have prototypes, and maybe in the second half of 2019 start production.

The last question about cash...

Berenice Muñoz Jalpa: Cash taxes.

Juan Pablo Sanchez Kanter: Cash taxes, as we mentioned in the past conference call, the effect that we had was in the first quarter of 2018, and this is because we had a higher advanced payment. The last payment of December made in January 2018 was higher, and also, we have to pay the presentation of the tax return corresponding for the fiscal year of 2017. We have to pay a complement during March. This represents a payment of around $10 million.

And the effect of this is, as we've mentioned in the past and during this conference call, we used all our taxes that we have, and we used it in 2016 and 2017. OK? And the effective tax rate that we have is 30%.

Mauricio Serna Vega: Got it. Thank you very much. And again, congratulations on the results.

Juan Pablo Sanchez Kanter: Thank you, Mauricio.

Operator: Thank you. Our next question comes from Guillermo Diego with Santander. Your line is now open.

Guillermo Diego Delgadillo: Maybe on the CapEx, can you just please tell us your expectations going forward? I think we were expecting $60 million for the year. Right now, I think we have over $30 million. So what's going to happen in the fourth quarter or really for 2019? That's the first question.

Juan Pablo Sanchez Kanter: Yes. Guillermo, we are in the same lines for the CapEx for this year. The MXN 60 million that we explained in the past conference call, there's no change in that. And for the next year, we are in the process of reviewing our information and at a proper time, we will let you know what our expectations are.

Guillermo Diego Delgadillo: OK.

And just on electricity, are you expecting further pressure for the next quarter or right now with the current levels of prices that are in the margins?

Juan Pablo Sanchez Kanter: This is a very good question, Guillermo. We had some conversations with people from the CRE, Comision Reguladora de Energia. This conversation took place 3 weeks ago, and they were saying that they were expecting a reduction in the cost of energy during the last quarter of the year. However, we saw that October also presented an increase.

Maybe I'm not answering directly because it's very difficult to know if we will have a reduction in the cost of the energy, no? OK. That's why as I mentioned in the question made by Mauricio, we are working very hard in order to define a power purchase agreement with some of the producers of energy for the future.

Guillermo Diego Delgadillo: OK. Thanks.

Operator: Thank you. Our next question comes from Valentin Mendoza with Banorte.

Francisco Duarte Alcocer: Hi, good morning to everyone. Actually, my name is Francisco Duarte, and I'm going to ask you questions on behalf of Valentin Mendoza.

Could you give us a breakdown in the expenses growth for the next quarter, please?

Juan Pablo Sanchez Kanter: In talking about expenses, we are expecting the same that we had last year, maybe with a little bit increase by the -- as you know, by the -- we are in the process of building a composite plant and that would affect or impact next quarter.

Francisco Duarte Alcocer: Thank you very much.

Another question is, are you expecting a catch-up in suspensions for the fourth quarter due to the effects of the phase-in, phase-out?

Juan Pablo Sanchez Kanter: As we've mentioned in the last conference call and this conference call, in the case of leaf springs, we will be having -- compared to the last year

-- we will be expecting the volume to be almost the same as what we had last year or 1% lower than last year. Then, as you will see, we will keep this expectation as we mentioned in the last conference call.

Francisco Duarte Alcocer: Thank you very much.

And the last one, when do you expect to start operations in the composite plants?

Juan Pablo Sanchez Kanter: The -- as I mentioned, we will finish the plant by middle of third quarter next year. We will produce prototypes during the last quarter of 2019. And we will say that by 2020, we will be in the production.

Francisco Duarte Alcocer: Thank you very much. Congratulations on the results.

Juan Pablo Sanchez Kanter: Thank you, Francisco. You're welcome.

Operator: Thank you. Our next question comes from Alejandro Chavelas with Actinver.

Alejandro Chavelas: Yes. Just to have a little more visibility regarding the brakes segment. You have had very good results in the last quarters. And just to see, if the pace of growth that you have had in the division would continue going forward?

Juan Pablo Sanchez Kanter: Yes. We don't see any change for the next quarters related to that.

Alejandro Chavelas: OK. Thanks.

Juan Pablo Sanchez Kanter: OK.

Operator: Thank you. Our next question comes from Carlos Aranda with Evercore. Your line is now open.

Carlos Aranda Gonzalez Guerra: Hello. Good morning.

My question is about light trucks fuel cost. In your slide, you mentioned that fuel cost is rising and I wonder if that will have an impact on North American demand for this type of light truck or SUVs? And could you give us some context on the last time that fuel cost was this high?

Juan Pablo Sanchez Kanter: Yes. We see the -- as we have seen in the SAAR and the levels of production that we have around 70 million, 70.5 million. And the expectation is from -- for example, from IHS, they are expecting to have this level in the coming years. In the projection that they have released, they are considering by the year 2020, a reduction in the GDP growth in United States because the yielding of the benefit of the tax -- U.S. tax reform, no? Then we can say that all those factors are factorized, and the expectation is to be in this level of 17 to 17.5 million units.

Carlos Aranda Gonzalez Guerra: Well, my question was more about, for example, consumers changing from light trucks and SUVs to smaller cars in the context of higher fuel cost?

Juan Pablo Sanchez Kanter: OK. Sorry. It's -- as I mentioned before, the OEMs and the things that we have heard and we know up to now is that we will keep this mix more light trucks than passenger cars. And right now, the light trucks are the more profitable vehicles for the OEMs. And also, I mentioned, Ford now is moving its strategy from passenger cars to light trucks. We can say that the OEMs are more focused on this and they are not looking or they are not expecting any change in this consumer preference.

Carlos Aranda Gonzalez Guerra: OK. Well, thank you.

And if I may, can you give us like any insight about how the USMCA deal will affect your company?

Juan Pablo Sanchez Kanter: Will affect what, sorry?

Carlos Aranda Gonzalez Guerra: Your operations.

Juan Pablo Sanchez Kanter: Yes. Operations affected by what? Sorry, we don't listen very well to your question. Sorry.

Carlos Aranda Gonzalez Guerra: No problem. It's about the USMCA deal.

Juan Pablo Sanchez Kanter: Talking about the trade agreement, no? Yes, we see the negotiation of the trade agreement as an opportunity to have stability in the business, increasing the modification. I think that will be a benefit for the company established in North America and to improve business.

Carlos Aranda Gonzalez Guerra: Well, thank you.

Operator: Thank you. Our next question comes from Alejandro Azar with GBM.

Alejandro Azar Wabi: Hi, Juan Pablo, Berenice, good morning. Congratulations on the results.

My first question is a follow-up on the composite plant. I just want to remember, when are the contracts for the full composite springs coming online, in 2020 or in 2021?

Juan Pablo Sanchez Kanter: The expectation would be in 2021.

Alejandro Azar Wabi: OK. Perfect.

And my second question is, when you mentioned several times the Ford case, that they are moving away from light trucks and they are leaving only the Mustang on the automobile segment. How should we think of that when you are exposed to those vehicles getting cut and maybe changing them? Because don't -- I read that, for example, the focus is going to be made on light trucks. So can you give us more color on that?

Juan Pablo Sanchez Kanter: Yes. No, we should -- yes, we -- sorry, Alejandro. Yes, there is a change of these platforms as you know. For example, in the case of the brakes business, we look -- Ford wants to get, let's say, passenger cars, pickups or SUVs or crossovers, no? For example, we are supplier of the Mustang and also we supply the Lincoln, Lincoln, the car and the crossover.

Then the activity is related more toward quotation. In this process, we are very close to the customer in order to, let's say, fight for the new business and try to get the -- try to follow the strategy of the customer. Always offering, as we have mentioned, innovation, quality service, etcetera. And in the other hand, if they move, for example, from passenger cars to pickups, but we are supplier of the platforms series they'd prefer.

Alejandro Azar Wabi: But my question is more -- and taking maybe an example, you -- I think you supply some parts for the Fiesta, and the Ford Fiesta is getting cut. How Rassini recovers from those contracts? Does Ford give you contracts on other vehicles, so you don't lose on your investment or...?

Juan Pablo Sanchez Kanter: No. As I mentioned, when the platform is finished for any reason, it's ended. And then the activity that we follow in the commercial area is how we can compensate that with all the new platforms. And that is the case in the case of brakes, that many we will be losing -- not losing -- we will be ending the platform because of the decision of the OEM. And we will be increasing our participation in other kinds of platforms.

But it's more related to the commercial area -- to commercial. As we see ending platforms, also we keep all these commercial activity in order to get all the platforms that help us to compensate this change in the preference.

Alejandro Azar Wabi: OK. And as of today, are you expecting a decline in volumes given the Ford decision to move away from sedans or...?

Juan Pablo Sanchez Kanter: No, because the shift on the consumer preference has been taking place for more than 3 or 4 years. And that would have been gradually, and we won't see any, let's say, future major impact.

Alejandro Azar Wabi: OK. Two more if I may, Juan Pablo.

If you have inventories on pickups by GM -- the days -- the inventory sales ratio of pickups?

Juan Pablo Sanchez Kanter: We have seen the average. It's not only pickups. The average for an industry is 65 days of inventory. And normally, the pick-ups are in the level of 70 to 75 days.

Alejandro Azar Wabi: 70 to 75, OK.

And one more if I may, Juan Pablo, I'm sorry. If you can mention more on the coil spring division, we have seen this division lose volumes on the back of lower production from sedans, etcetera. But what should we expect going forward? Do you have new contracts? When can we see the growth in this division?

Juan Pablo Sanchez Kanter: Yes. This division was impacted because of this change of preference from passenger cars. And we will say that the -- in the future, we are looking for additional contracts and we will be launching some contracts, but we will not be able to compensate the reduction in volume that we are facing right now.

Alejandro Azar Wabi: OK. Thank you. Thank you very much, Juan Pablo, and congratulations on the results again.

Juan Pablo Sanchez Kanter: Thank you.

Operator: Thank you. As there are no questions at this time, I would like to turn the call back over to Berenice Muñoz Jalpa for closing remarks.

Berenice Muñoz Jalpa: Thank you again for joining us on the call today. If you have remaining questions, please do not hesitate to reach out to me or to anyone on the team. We look forward to speaking to you over the next three months and delivering strong fourth quarter fiscal 2018 results. We wish you a good day. Thank you.

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

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