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CORPORATE PARTICIPANTS

Adrian Althoff

Alberto Sada Medina *Nemak, S. A. B. de C. V. - CFO*

Armando Tamez Martínez *Nemak, S. A. B. de C. V. - CEO*

CONFERENCE CALL PARTICIPANTS

Alejandro Azar Wabi *GBM Grupo Bursátil Mexicano, S.A. de C.V. Casa de Bolsa, Research Division - Research Analyst*

Alejandro Chavelas

Alexandre Pfrimer Falcao *HSBC, Research Division - SVP*

Chelsea Colon

Christian C. Landi *Scotiabank Global Banking and Markets, Research Division - Deputy Director of Metals & Mining and Associate*

Erik McKee *Lazard Asset Management LLC - Director, SVP, Portfolio Manager, and Analyst*

Gilberto Garcia *Barclays PLC, Research Division - Assistant VP and Equity Research Analyst*

Glenn Zahn

Jose Vazquez

Juan Tavarez *Citigroup Inc, Research Division - Director and Analyst*

Luis Miranda Valenzuela *Santander Investment Securities Inc., Research Division - Head of Food and Beverage*

Valentín III Mendoza Balderas *Casa de Bolsa Banorte Ixe, S.A. de C.V., Research Division - Research Analyst*

PRESENTATION

Operator

Good morning, everyone, and welcome to Nemak's Fourth Quarter 2017 Earnings Conference Call. At this time, I'd like to introduce Armando Tamez, Nemak CEO; Alberto Sada, CFO; and Adrian Althoff, Investor Relations Officer. They're all here this morning to discuss the company's performance and answer any questions that you may have.

As a reminder, today's conference is being recorded and will be available on the company's Investor Relations website. I'd now like to turn the conference over to Adrian Althoff. Thank you, you may begin.

Adrian Althoff

Thank you, operator. Good morning, and welcome, everyone. We very much appreciate your participation. Armando Tamez, our CEO, will lead off today's call by providing an overview of our business and financial highlights. Alberto Sada, our CFO, will then discuss key industry trends and our fourth quarter financial results in more detail. Afterwards, we'll open up for a Q&A session.

Before we get started, let me remind you that information discussed on today's call may include forward-looking statements regarding the company's future financial performance and prospects, which are subject to risks and uncertainties. Actual results may differ materially, and the company cautions not to place undue reliance on these forward-looking statements.

Nemak undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. I will now turn the call over to Armando Tamez.

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

Thank you, Adrian. Hello, everyone, and welcome to Nemak's Fourth Quarter 2017 Conference Call. We saw another positive trend in demand for our components in the fourth quarter across the markets we serve. New program launches in our European operations drove consolidated volumes 1.7% higher, with customer demand in North America and Rest of the World remaining stable.

Revenues increased 9.8% due to higher aluminum volumes and aluminum prices. However, aluminum prices also increased on a sequential basis, which as we have discussed in recent quarterly goals, represents a headwind for our results.

EBITDA decreased 10.8% in the period, mainly due to the adverse impact of negative metal price lag as well as higher launching expenses, particularly in North America.

For the full year, EBITDA was affected by the same factors behind quarterly variations, finishing 10.4% lower than in 2016.

Volumes decreased slightly compared to the previous year, as lower customer demand in North America narrowly outweighed growth in Europe and Rest of the World. Meanwhile, revenues increased 5.3%, driven by higher year-over-year aluminum prices.

During the quarter, we continue to scale up production of our first 7 programs in structural and electric vehicle component, while advancing with test production runs in 3 others. Our efforts to meet and exceed our customers' expectations for these programs enabled us to generate approximately $100 million in revenues in the structural and electric vehicle components for 2017, making it our first year with substantial revenues in the segment.

We also secured new business that will enable us to provide higher value-added content to our customers in the structural and electric vehicle components, while making further inroads in the implementation of our technology roadmap and our strategy.

In particular, I would like to highlight 2 new programs which we obtained in the quarter. One, to produce structural components for electric applications of Volvo in China, marking our entry into that country's fast growing EV market. And one to provide just-in-time delivery of fully assembled structural components to both gasoline and battery electric vehicles for Daimler, representing a new milestone in our efforts to grow in our capabilities in high value-added lightweighting solutions. With these wins, we increased the size of our total order book in the structural and electric vehicle components to approximately $320 million in annual revenues.

For the quarter and full year, we secured new contracts across our business lines, worth a total of approximately $130 million and $830 million in annual revenues respectively. Building on our innovation track record, this past November, we were selected as a winner of one of the world's most prestigious awards in research and development, the R&D 100 awards. This recognition was based on the role in the development of a new class of super alloys that delivered vehicle lightweighting benefits superior to those of currently available alloys, underscoring our efforts to contribute towards a more sustainable automotive industry.

In October, we were named as a finalist for the 2018 Automotive News Pace Awards for the development of our patented lightweight Rotacast aluminum casting process, representing a proven cost-effective solution for casting high-performance engine blocks with extensive design flexibility, we see Rotacast as a pillar of our powertrain business.

Also, during the quarter, I am pleased to share that we received 2 important awards from customers in Asia. One for quality and performance from

Changan Ford, and the other one for technology and innovation from Tata Motors.

Lastly, on the financing front, this past January, we successfully placed a new 7-year $500 million bond issuance at 4.75%, the proceeds from which will be used to prepay previous notes from the same amount due in 2023. We expect that the issuance will yield financial savings in the amount of $3.75 million per year. With that, I will hand off the call to Alberto Sada, Nemak's CFO.

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Thank you, Armando, and good morning, everyone. Let me start by providing an overview of auto industry performance in our main regions to provide some context for our results in the quarter.

Regarding North America, U.S. vehicles sales showed a 1.6% reduction year-on-year, consistent with expectations of industry analysts.

Vehicle production declined 4.1% year-on-year in the region, as OEMs adjusted production to reduce inventory levels towards historical averages.

Meanwhile, in Europe, the market showed contrasting trends, whereas vehicle sales declined 1.4% due to softness in Western Europe, production grew 7.9% year-on-year, with exports outside of the region accounting for a large share of the growth.

Additionally, we saw an accelerating shift in vehicle sales mix, with customer demand driving a shift towards gasoline vehicles and away from diesel. We have seen diesel share of new light vehicle registration in Western Europe decline from 49% in December '16 to 42% in December '17. While on the one hand, we experienced a reduction in our diesel volumes this quarter. On the other hand, this effect was more than compensated by gasoline applications and new program launches.

Our volumes were 12.0 million equivalent units, a 1.7% increase year-on-year, mainly due to new program launches in Europe.

In turn, revenues were $1.1 billion, a year-on-year increase of 9.8% due to growth in volumes, together with higher aluminum prices.

We reported consolidated operating income of $66 million, 26.7% lower than the year-ago figure. This result was mainly due to the following 2 factors: first, rising aluminum prices resulted in a continuation of negative metal price lag. This effect was accentuated by recent increases in premiums on primary aluminum in North America, creating a divergence between our buying and selling indicators, which historically have been very closely correlated. The total impact of negative metal price lag for the quarter was around $11 million, 2/3 of which is explained by the divergence just mentioned.

We are currently in discussions with our customers over pricing adjustment to account for the situation; and second, we incurred extraordinary manufacturing expenses associated with new program launches in North America. This included higher-than-expected labor and shipping expenses to meet customer production schedules. Given the progress we have made in these launches in recent weeks, we expect that these line items will normalize in the first half of 2018.

Reflecting the reduction in operating income, EBITDA finished at $166 million, 10.8% lower than 4Q '16. In turn, EBITDA margin and EBITDA per equivalent unit were also lower than a year ago. EBITDA margin was 15.2% compared to 18.7% in 4Q '16, and EBITDA per unit was $13.80, which compares to $15.80 a year ago. Despite the decrease in EBITDA, our free cash flow was $40 million better than the same period last year, which speaks well of our capacity to prudently manage outflows, such as working capital and capital expenditures, under challenging industry conditions.

Net income amounted to $36 million, a 40% decline over 4Q '16. The main factors were the reduction in operating income, which I already mentioned; plus, foreign exchange fluctuations, in particular, the effect of the appreciation of the euro against the dollar.

Next, I would like to touch on our CapEx program. In 4Q '17, we invested $109 million, adding capacity and revamping equipment across our regions and product lines to support new program launches.

Now let me cover our regional results. As mentioned before, the North American auto industry reported lower year-on-year figures for both sales and production as major OEMs reduced inventory levels. Despite the industry reduction just described, our volumes for the region remain stable on the back of new program launches. 4Q '17 North America revenues increased 7.5% year-on-year due to higher aluminum prices. EBITDA for the quarter was $92 million, 22.7% lower than last year.

In addition to the metal price lag and launching expenses already mentioned, we saw lower year-over-year production at our operations in Mexico, where we have higher margins compared to other parts of the region.

Turning to Europe. We reported 5.6% increase in volumes, supported by a strong overall market, as well as new program launches. On top of that, the appreciation of the euro against the U.S. dollar and higher aluminum prices allowed us to obtain a 19.4% increase in revenues. Altogether, these positive factors outweighed negative metal lag and increased launching expenses, driving EBITDA growth of 12.7% year-on-year.

Our volume in Rest of the World was flat in 4Q '17. We saw lower production in China, whereas Brazil recorded higher volume on the back of new program launches. On a year-over-year basis, Rest of the World volumes were flat, while revenues decreased 7.8% due to sales mix and exchange-rate.

Meanwhile, EBITDA remained unchanged at $12 million. I will now like to hand the call back to Armando for some additional remarks.

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

Thank you, Alberto. Before opening the call for questions, I would like to say a few words on our outlook for 2018. First, in line with the strategy update we provided in our investors day last September, we see 2018 as a transitional year, marked by investments to strengthen our foundation for a strong growth over the medium to long-term. We have been investing resources in both our powertrain business and our new structural and electric vehicle component business towards this end. And we will continue doing so to the extent it is needed to support our recently awarded contracts.

In the short-term, however, we also recognized there are key external factors related to our business. In particular, trends in aluminum prices and light vehicle production that may have an impact on our results.

With this context in mind, our guidance for 2018 is as follows: for volume, we expect 50.1 million equivalent units; revenues of $4.5 billion; EBITDA of $700 million, and last, CapEx of $384 million.

We reiterate that we see a strong potential for our business in emerging growth opportunities, linked to vehicle lightweighting and electrification. We are committed to maintaining our leading position in our field so that we can capitalize on such opportunities in the coming years. With that, we will open the call for Q&A.

Rob, please instruct the participants on how to place their questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Christian Landi with Scotiabank.

Christian C. Landi - *Scotiabank Global Banking and Markets, Research Division - Deputy Director of Metals & Mining and Associate*

I believe that the most, the biggest part of the EBITDA per equivalent unit impact was related to the metal lag. I had calculated that it was between $15 million and $20 million in the quarter. This $11 million, that you mentioned, was just related to this divergence, right? So the total metal price lag impact, is it close to the figure, I said, like $15 million?

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Yes, this is Alberto. No, actually the total metal lag impact that we saw in the quarter was $11 million. That's both, the normal metal lag, as we have described, and this particular divergence that we are starting to see in the last part of 2017. So it's both.

Christian C. Landi - *Scotiabank Global Banking and Markets, Research Division - Deputy Director of Metals & Mining and Associate*

It's both, okay. Any chance you -- I mean, if this metal price impact -- metal price lag impact, which is temporary, hadn't been there, any approximation of what EBITDA per equivalent unit you would have delivered in the quarter?

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Well, certainly half of the effect on a global basis was the metal lag. So hadn't we had that metal lag, it would be half of the difference, which should be about 1 dollar per piece.

Operator

Our next question is from Alexandre Falcao with HSBC Global Asset Management.

Alexandre Pfrimer Falcao - *HSBC, Research Division - SVP*

That's not really asset management, but we go with just HSBC. Now just wanted to -- I have 2 questions. First one on the guidance. Can you break down a little bit on your revenues between regions, where do you expect more strength? Europe -- since you closed out the year very strongly, just wanted to know if your guys see that smoothening down a little bit?

And the second question is regarding NAFTA negotiations. It seems like right now there is the national content part of the negotiations are, you can almost write those off. Just wanted to know, if that is the case, it's a regional content? What does change for you? Have you guys prepared any scenarios for it, if that happens?

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Yes, Alex this is Alberto. For the first part of the question, yes. Just to give you some colors, we normally don't give guidance on a per region basis, but I can tell you, more or less, how the general trends are happening on the region. For North America, I think we are continuing seeing the same trend. So going forward we see, for 2018, slightly lower volumes. However, little bit of mixed improvement, as we see production -- slightly high production in Mexico which is what we experienced in 2017. Europe, we see slightly higher and there we have 2 effects, on one side we have the positive effect of launching of structural components and some [block] programs, but also we're seeing little a bit of headwinds on the diesel side that we're eventually catching up, but that's more on the half -- second half to the -- let's say, for the next 18 months.

And then the Rest of the World, we continue seeing very positive developments, both in Asia and South America, but we are seeing Asia growing on the back of new program launches, that we are developing as well as little bit of the recovery in South America as well as new program launches. So it's a mix, and I would say positive for Europe and RoW, slightly negative for North America, yes.

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

Second part of your question is related to NAFTA, let me just share what we have been -- let's say, listening and watching from different fronts. We have close contacts to the Mexican negotiators as well as close contact, to some extent, to some of the negotiations in the U.S. and Canadian markets. We are still confident that the 3 countries will reach an agreement. It is expected by March, that the next meeting will be held in Mexico City and Mexico is preparing some proposal, as -- just as we have indicated during the Nemak Investor Day. Certainly, the U.S. put certain conditions on this proposal to increase local content. I think the Mexican authorities, in our opinion are preparing something related to that, to increase that additional content, but not to any particular country, but to the region. I think that will be put in on the table. We are still confident that it's beneficial for the 3 countries, and in the unlikely event that for some reason they will not be able to get an agreement, as we have presented in our Investors

Day, only 20% of our total revenues are exported to the U.S. from Mexico, and our understanding is that the maximum duty that could be imposed on our parts will be 2.5%. And certainly, we will make sure that these expense, if it comes, we will ask our customers to take care of them.

Operator

Our next question comes from Luis Miranda with Santander Bank.

Luis Miranda Valenzuela - *Santander Investment Securities Inc., Research Division - Head of Food and Beverage*

A couple of questions. The first one is, Alberto, you -- just following up on the extraordinary charges. You mentioned $11 million on the metal price lag and can you give us an idea of the magnitude for the launching of the new programs? How much was the impact?

The second question is, with regards to the outlook in terms of the bidding process for new structural components and electrical vehicle projects, as you were mentioning in the Nemak Day, you mentioned, you identified close to a $500 million. I don't know if you could give us an update, how comfortable do you feel with that number?

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Yes, Luis. Related to your first question, the difference in EBITDA that we saw in the fourth quarter is basically twofolds. So on one side, we discussed metal lag and the other major, let's say, external expense we had was launching expenses, particularly North America. This accounted to about $9 million in the quarter and mostly related to extraordinary manufacturing expenses, as I described before. A little bit more shipment expenses et cetera, those are, let's say, extraordinary expenses associated with the ramp-up of products that we see, primarily, in North America, yes.

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

Luis, to answer the second question related to the pipeline that we see, as we've indicated in the Nemak Investor Day, we are still working very closely with the customers, just again talking to our commercial team, as we speak, we are currently talking to 30 existing and new potential customers about opportunities on the EV side as well as the structural components. We have estimated that we have between $500 million to $600 million worth of potential additional business and certainly since we're making good inroads, not only in Europe, but also in Asia. We are confident that we will continue getting new orders. And as soon as they come, certainly, we will be updating our guidance in terms of new orders for structural as well as EV components.

Luis Miranda Valenzuela - *Santander Investment Securities Inc., Research Division - Head of Food and Beverage*

Okay. Just, Armando, just to follow-up on this question is, do you think that these 30 potential customers partially benefited by the change or the new structure -- the changes that you made in the structural component last year? Is it helping? Are you seeing any benefits already?

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

Yes, absolutely. This is an industry that normally customers tend to be conservative and they like to do business with companies that have a very -- let's say, proven to the market that they can produce and deliver these type of components. So right now, as we have indicated, we are, as we speak, producing 7 new parts in different regions, mainly in Europe. I will say that 90% is in Europe. We are also producing parts in North America, and we will start producing parts in Asia very soon and that certainly, customers take a look and see how you're performing, and also they look at the potential, in terms of technology, quality and so on. So those are some things that, in our opinion, will give us an advantage and certainly, we are looking to get additional new orders. And as we have indicated, we expect that this business, will yield better profitability than our core business.

Certainly, we will need to work to this learning curve in which we are trying to, again, learn as quickly as possible, so that we can develop the higher efficiencies as well as get the best profitability that we can.

Operator

Our next question is from Gilberto Garcia with Barclays Bank.

Gilberto Garcia - *Barclays PLC, Research Division - Assistant VP and Equity Research Analyst*

Can you comment on your plans regarding dividend for the year?

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Gilberto, we will be proposing our dividend payment during our General Assembly Meeting, which is scheduled late February. So that's when we will give, let's say, the approved amount.

At this point, we cannot share our plans. You have to wait for the approval of the general assembly. We expect a similar rationale as we had in the past of trying to provide free cash flow in excess of our CapEx as dividends.

Operator

Our next question is from Erik McKee with Lazard.

Erik McKee - *Lazard Asset Management LLC - Director, SVP, Portfolio Manager, and Analyst*

Just, I think you partially answered my one question. But if you were to say, your structural components plus EV, was that 90% Europe? I have another question as well.

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

At this point in time, yes, certainly European, because they have higher requirements in terms of emissions and CO2 reduction. Certainly, they are moving at a much faster pace than their counterparts in North America, as well as their counterparts in Asia. That's why we have more, we expect, in Asia as we have indicated before, that the Chinese government will increase the requirements in terms of CO2 emissions, as well as fuel efficiency and we believe that, that will certainly create an opportunity for us as well. As everybody knows, the Chinese government has already indicated that they want to become the leading producer of electric vehicles in the world. So we estimate that we will be able to get new orders in that market as well. In North America, I think, it is important also to say that, as we speak, the administration of U.S. is reviewing the numbers related to CAFE or miles per gallon required, those will be defined in March. And we will be, let's say, looking at those, and certainly depending on the new regulations, our customers will have to pay or adjust to these new requirements.

Erik McKee - *Lazard Asset Management LLC - Director, SVP, Portfolio Manager, and Analyst*

And just, secondly, just regarding metal price lag, I guess, the results were different than I was expecting. I mean, if you look at COGS, look at cash COGS per unit, it was actually down quarter-over-quarter, but you're suggesting metal price lag there. And then, I also look at ASPs, or revenue per unit, however, you want to call it, were actually down this quarter, quarter-over-quarter -- and they were down quarter-over-quarter in 3Q as well. Is this just a massive mix effect? Or, you know, whatever -- shipping lower quality products? And then your Rest of the World ASPs were down

27.5% quarter-over-quarter. I'm just trying to understand, was just this really big swings in types of products that you are selling? Or what's leading to it?

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Yes, Erik, this is Alberto. No, I think, what we saw in the Rest of the World was a little bit of a combination of both mix and effects. What we are seeing there -- it's -- in relative terms, it's obviously less than on the consolidated basis, but there were some, let's say, mix changes, as we saw little bit less volumes in China versus higher volumes in South America, and we have a totally different price structure. So that's the main reason why we have this fluctuation in the Rest of the World.

For the other regions, I have to check exactly the ASP or the revenue per part. But generally, what we saw in North America, was a little bit of a shift in mix, as we were producing little bit more volumes in the U.S. versus what we were producing in Mexico. And those, I mean, depending on the types of products, if it blocks or heads or different products they have different profitability. But in general, the EBITDA per unit will be lower in the U.S. versus what we have in Mexico and the reason for that is essentially production schedules. There is no preference or no discretionary shipments or quality issues or anything like that. It's just how the production schedules are being laid out by our customers.

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

So yes, the primary adjustment on that is, as we said, is this divergence -- talking about metal lag, this divergence in indicators that I just explained, what we're seeing, primary aluminum picking up dramatically, given speculation that we are seeing. In particular due to the Section 232 discussions at the Department of Commerce in the U.S., where they are thinking of imposing tariffs to both steel and aluminum. So that's generating this imperfection in the market that is affecting a part of our cost, and is not being translated to our revenue. So that explains a little bit of the COGS or revenue mismatch.

Erik McKee - *Lazard Asset Management LLC - Director, SVP, Portfolio Manager, and Analyst*

I mean, is there any sort of timing that you might expect North American margins to return? Or is that -- will you require your customers accepting to pass through some of these prices? It's not really part of the existing agreements or...

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

It is. I think the -- traditionally, let's say, whole indicators worked completely in tandem, both from the basket of indicators with which we buy versus our selling. What we saw now is just for that portion of primary aluminum picking up in particular in the U.S. We are seeing these premiums going up and that's what we're discussing with our customers to adjust the formulas to reflect better divergence that we are seeing lately in 2017, so that we fully pass through the pricing as we have had in the past.

Operator

Our next question come from Juan Tavarez with Citi.

Juan Tavarez - *Citigroup Inc, Research Division - Director and Analyst*

So my first question is just to get some clarification on your backlog for the structural components. You mentioned that you now have a backlog of $320 million on an annual basis. What's the time frame for us to see that materialize? Is this $320 million going to come in 2018?

And then second, just kind of tied to that as well, just to understand your guidance for 2018, it looks very similar to what you delivered in 2017. So I am curious, also the comments you made that North America looks like it's slightly lower. but with a better mix, Europe is looking slightly better and Rest of the World is very positive. Why aren't we seeing any growth and profitability, and maybe if you can share, what's your kind of [FX] view or metal price view embedded in your guidance?

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

The first part, Juan, related to when do we expect to have the EVs and structural components at full production, it is going to be by 2020. We are ramping up our production. We are expecting this year -- by the end of the year to be at approximately between $150 million to $170 million in revenues. And as I have indicated, we are ramping up the production of these components in different plants in Europe, North America, and will start also in Asia. And we are confident that again, we will be producing the $320 million by 2020. And as we have indicated, again we are confident that we will continue getting new orders on both electrical as well as structural components.

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

And Juan, in connection to your second question around the guidance. Yes, certainly, our EBITDA for 2018, we are guiding it to be at very similar levels of what we had in '17 and there is a mix of items that, let's say, have an effect in 2018.

I think the primary item is volumes, and as we highlighted, the volumes are relatively stable with the effects that I just described, where we're seeing North America slightly lower, Europe is slightly higher there, with a little bit of mix effects between growth and structural components and some negative effect on the diesel side; and relatively strong Rest of the World operation. So that's what we are incorporating. Volume is a main driver for EBITDA. I think at the same time, we have a few tailwinds and headwinds.

On one side, the metal lag situation is clearly a headwind. We also are assuming additional expenses associated with launching of structural components and we are preparing to be ready to launch and capture significant volumes in the future. For that reason, we are anticipating that we may end up having some extra expenses that we'll recover in the future with new business. I think also, economics is a plus and minus. We are seeing a little bit better performance in Rest of the World, and also expect little bit better performance and less launching expenses in North America. So the combination of everything that I just described, essentially puts us at the level that we just guided for 2018. We certainly will be reporting progress in the year.

Juan Tavarez - *Citigroup Inc, Research Division - Director and Analyst*

And maybe, if I may, just one more question, just on the back of the U.S. Tax Reform. I'm curious if you've seen any ways to, I guess, to see any benefit into 2018 or 2019? Either on your CapEx deployment or on just incremental savings into the year-end, anything to highlight there?

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Yes. Actually in the short term there is no effect on our side, as we had NOLs and we had a relatively low cash tax basis, but mid-term, long-term, definitely we will see there some improvement as we'll see obviously a lower expected cash tax basis for U.S. operations.

Operator

Our next question is from Alejandro Azar with GBM.

Alejandro Azar Wabi - *GBM Grupo Bursátil Mexicano, S.A. de C.V. Casa de Bolsa, Research Division - Research Analyst*

Just a follow-up on the tax reform, could you mention a possible impact, a possible benefit on the U.S. operations. And another one is, I couldn't quite hear the savings on the restructure of the bond, could you repeat it please?

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

Yes, the savings on the bond, represent -- we have, Alejandro, a 5.5% bond that -- and we issued a new one at 4.75% for the same amount, $500 million that would represent savings of about $3.75 million in financial costs per year.

Alejandro Azar Wabi - *GBM Grupo Bursátil Mexicano, S.A. de C.V. Casa de Bolsa, Research Division - Research Analyst*

Perfect, and related to the tax reform, did you saw any benefit during the last -- during the end-of-the-year? Are you seeing a benefit for 2018? Can you comment on that?

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Yes Alejandro, as it was indicated that on the short term we're not seeing any change. We already enjoyed a very low effective cash tax rate in the U.S., because of the historical NOLs that we had back since we did some acquisitions in the region. So we are still depleting those NOLs and that's why in the short-term, we don't see a direct benefit. Though we will definitely be able to see a little bit of positive benefit in the future as those NOLs exhaust and we move to the nominal tax rate in the U.S.

Operator

Our next question is from Alejandro Chavelas with Actinver.

Alejandro Chavelas

Just a couple of clarifications. I'm still not quite clear on why average profitability per unit will remain at 2017 levels, given that metal lag was a significant part in this. I'm just trying to understand, how much would launch expenses, in particular, affect profitability? Would this (inaudible) either increased launching expenses in affecting profitability per unit?

And the second one, if you could comment maybe, on how -- what do you expect in negotiation of the -- well, the resolution regarding CAFE, regarding the fuel efficiency decision by CAFE that will take place in March 30? Do you expect upside from this decision for lightweighting? Or is it more on the negative side for lightweighting? That will be all from my part.

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Yes, Alejandro, related to your first question, related to profitability. I think the comments you are mentioning are correct. I mean, we had some extraordinary effects in 2017 associated with this metal lag as well as these launching expenses that we experienced, particularly in North America and earlier in the year in Europe. However, we are seeing in 2018, also additional expenses associated with our readiness to structural component. We're teaming up with a [big], let's say, an important team, particularly in Europe, to get ready to develop and sell and capture all those orders. So we'll have a little bit more of those expenses though, and '18 will be different than what we saw in '17 in terms of where those launching expenses happened. And again, this is in our sales preparing for this important growth that we are seeing and to be able to capture more orders for structural components and EVs. Metal lag for this year is still unknown, so on that one, we still need to see where it goes.

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

Alejandro, related to second part of your question about regulations, as we have indicated during the Nemak Investor Day, our customers are basically in 3 main regions, North America, Europe and Asia. And our customers are facing a big dilemma, because the 3 regions, they have 3 sets of different rules and regulations, and they are trying to define their strategy. I think it's important to remember that 60% of the revenues come from North America. In the event, and most likely that will happen, is that the CAFE regulations will be reduced in North America, we see an opportunity by the following: certainly, we will not see a significant increase in electric vehicles in North America. That certainly will imply that we will not grow in that segment, at least in this region. And that would will mean that our customers will continue using their existing powertrains. For us, I think, it is not bad, that will require for Nemak less investment and use existing assets to produce and continue, let's say, producing our products, add some blocks in the region. We see a totally different picture in Europe, where authorities are very strict in terms of regulations as well as in China. So we will play it by ear and certainly, we will need to wait until it is official that the U.S. potentially may reduce their corporate average fuel efficiency in the region.

Alejandro Chavelas

Okay. Just a follow-up question. Would you say that guidance for the year is on the conservative side? Or do you feel confident about the $700 million in EBITDA, I mean, (inaudible)?

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

This is our best view, Alejandro, of how do we see let's say, the year and certainly if we see additional benefits, we will inform all the investors community at the proper time.

Operator

Our next question is from Jose Vazquez with GBM.

Jose Vazquez

I have a question on North American production. Could you break down your exposure by type of vehicle? How much is to light trucks and how much is to light vehicles?

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

José, I think in North America we have, as you know, a relatively high share. So I don't think we have any additional concentrations than normal. So we are exposed to all vehicle segments from the passenger cars to the SUVs and CUVs within our customers, right? So there's a segment that we don't serve, in particular, the Toyota and Honda markets, but everybody else -- its -- we're the largest suppliers of all of them, and our products go in all the different vehicle segments from the very small engines that go into small passenger cars to the very large engines that go into pickup trucks and large SUVs. So it's -- our exposure is as diverse as the mix of cars and trucks that you see in North America. And if you recall the market is moving towards more the larger vehicles or the SUVs, CUVs versus cars. But that's, let's say, not because we're exposed to one particular one, but we are selling to all of them.

Operator

The next question is from Chelsea Colon with TIAA.

Chelsea Colon

Just have a couple of questions. You mentioned about $20 million impact from the combination of this metal price lag and startup expenses. But what would make up the remaining $15 million or so that represents the gap between your guidance and the actual EBITDA achieved?

And then my second question is also in terms of margins. I remember, couple of years back now, when you were expecting the structural components segment to get more grow much more rapidly, I think your target was March 2020. You were also talking about margin at the consolidated level about 18.5%. But it seems like they've kind of stabilized around the 15% to 16% level. So I'm wondering if you are still expecting to be able to increase margin in that way, maybe on a more delayed basis and what would be the drivers behind that? Or if should we be expecting the 15% to 16% to be kind of at the steady state for the future?

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Yes, sure, Chelsea. Thank you for questions. Related to your first question about the gap between the implicit fourth quarter figure versus our guidance, the majority of the difference comes from a little bit less volumes that we had anticipated. We are expecting a more stronger quarter for the fourth quarter of '17 and this came as small reductions -- not small, but some reductions that we saw in volumes in Europe. Europe, had we not seen the diesel as a mix change into gasoline, we have had more volumes there that would have made up for most of the gap versus our guidance. So that's also incorporated in our 2018 figures, we're seeing this mix change. Though we are catching up, gasoline variance in some cases it takes a little bit of time for us or us to get those products. So that's the main reason for this gap that we saw, in addition to the metal lag and launching expenses that I just described.

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

Chelsea, related to your second question. Certainly under the new administration in the U.S., we saw a change immediately, after President Trump took office, he immediately gave instructions for his team to review the CAFE regulations. And they said that they will take one year to review, talk to different parties to try to understand better, if what the previous administration of President Obama set as targets. Just to remind you, under President Obama, we have a target of 54.5 miles per gallon to be reached by 2025. Based on that, we certainly have some expectations about how the structural component business, as well as electric vehicles will penetrate the U.S. market.

Last year, certainly, we acknowledged that and moved our target to reach the $1 billion in revenues for this new business by 2022. We are still confident that these figures could be reached by that time. Certainly, we will need to watch what is going to be the new regulations in the U.S., if they are to change. Related to margins, we are still confident and that's the way that we are the (inaudible) since there is no capacity in the industry, we are expecting to have a reasonable profitability, at least 200 basis points higher than our core business. But I think it's important to acknowledge that we have a learning curve. We will have again some efficiencies that we need to improve in our launching of new products. But yes, we are confident that we could reach those profitability levels once we stabilize and we get larger scale.

Chelsea Colon

So at the consolidated level in 2022, what would the margin expectation be?

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

Yes, we are expecting again to have basically about 17% or 18% profitability on those new products. We expect, certainly that by that time, we will have created internally some efficiencies and also that we will be able to price our product more competitively. But we are expecting at least 17%, 18% margin on those products by this 2020, '21, '22.

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

And just to complement, and I think, to follow-up on the margin question, if you see it on a unit basis, you'll see a gradual increase of those margins, because the percentage on sales has this metal effect that has -- increases or decreases the denominator. So we are expecting to land at about $16.50 to $17 per piece.

Operator

The next question is from Valentín Mendoza with Banorte.

Valentín III Mendoza Balderas - *Casa de Bolsa Banorte Ixe, S.A. de C.V., Research Division - Research Analyst*

This is a follow-up question regarding your launching expenses. I was wondering if you could walk me through to understanding, what had changed from the previous earnings call, when you mentioned that you weren't expecting any further increase in launching expenses in the fourth quarter and nor in 2018, and now you are having this, I'd say, lagger in your profitability for 2018?

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Yes, Valentin. Thanks for your question. Absolutely, the launching expenses are the result of multiple things. On one side it's the, let's say, the ramp up of products, but at the same time we try to calculate what is the additional cost, while we reach full capacity usage. But also, unfortunately, you see some changes happening on the demand of our customers that tend to drive higher, let's say, temporary costs or lower temporary costs, depending on those pulls. And that may mean having to work 7 days a week to meet shorter or pull ahead of time or increase in the ramp-up of volumes, or changes in the time, which also have a corresponding effect. So altogether that generates additional labor expenses in terms of overtime, in terms of additional crews to work 7 days a week. And also in some cases, we have to expedite shipments by -- to be able to meet just-in-time deliveries.

And we have a lot of work happening at our plants, particularly in Mexico that drove those expenses higher in 2017 fourth quarter. And for 2018, we are seeing a slightly different additional expense, not more in the same fashion as what we had in the fourth quarter, but more this additional expense to be ready to team up our efforts in structural components and EVs by increasing our group of people, the engineering staff as well as some development expenses, new R&D projects that we are incurring to be able to tap better and gain more structural components and EVs. So most of the extra cost that we will be experiencing in '18 will be associated with the activities geared towards future growth.

Operator

Our next question is from Glenn Zahn with Commerzbank.

Glenn Zahn

A question on your metal lag. Can you explain a little bit how the mechanics work? I mean, I assume you have this language in your contracts with your customers, and if we see a price increase -- I mean, what generally is the lag -- are we talking a 1-month lag, a 3-month lag?

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Yes, Glenn. The metal lag it's definitely, or let's say, little bit differently. The formulas that we have in our prices, which are established in our contracts, they vary by customers, but in general they have a 2-month -- 2- to 3-month metal lag, depending on the region and the customer. So that mean that we are selling with the prices of the last 2 months or 3 months now, and we are buying, given the nature of the market, most of our cost in spot basis. So that generates -- when the metal goes up, that generates a negative effect, on a temporary basis. And when the metal goes down, it generates the different effect. And I think in 2014 -- in the fourth quarter of 2017, we saw something slightly different than that and that's why we said that we are talking to our customers to adjust those pricing, because we saw a divergence in some of the indicators that we used to buy materials versus the indicators we have to sell. So, traditionally, these indicators have been fully correlated and for that reason a full pass-through effect was materializing. But given this special situation with the speculation around potential legislation changes in the U.S. around aluminum trade, import duties potentially that has generated increase in premiums for primary aluminum in the U.S. Totally different than what we have seen on the secondary market and this divergence is creating this additional gap we saw in the fourth quarter. So this the one that we need to adjust on our contracts with our customers, to make sure we that we have full pass through as we've had in the past.

Glenn Zahn

And it looks like prices are off, coming into January, so we are not going to see any lag effect going if things continue at this trend, we shouldn't see any, of course, any lag effect in the first quarter?

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Well, it will be hard to see. We saw a little bit of uptick in prices in December and January, coming a little bit down on the last couple of weeks, but who knows. We saw also similar effects in September-October time frame, but then picked up so unfortunately, this is market situation and we'll have to continue monitoring development and we trust we are going to be able to come to a resolution with our customers affected.

Glenn Zahn

And then, you talked about these extra costs that you're going to get in 2018, I think you mentioned on the revamping cost, a little bit different from the launch expense you had last year. But can you just quantify them? Are they in the same level as last year? Or are they going to be significantly more?

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Well, no, not significantly more. Probably around the same level as we saw last year, but again, this is more additional cost we are incurring for developing structural components and setting up the organization's engineering team, product development et cetera, to tap fully that market. Potentially the orders could come up well -- higher in 2018, we do need to have -- we're let's say getting ready to have all the resources available. So that's taking extra cost that we will eventually recover with sales and ramping of new products in the following years. But on order of magnitude, those should be more or less equivalent, but they are different in nature.

Glenn Zahn

And you mentioned that there's going to be a meeting in Mexico City with NAFTA etc., they might slap extra duties, tariff on you. And you're confident that you -- and what makes you so confident that you can pass that on to your customers? And also, too, you do have, I believe, production facilities in the U.S., how much can you -- actually can you mitigate any tariff effect by ramping up production in the states?

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

Let me just clarify, Glenn, that they will have the seventh meeting between U.S., Canada and Mexico in March, continuing negotiations with the free trade agreement or the NAFTA. And I'm not saying that they will solve this issue. What I -- what we have heard from the Mexican side is that Mexico is preparing a proposal, especially on the auto sector related to local content. This is something that the Mexican government is going to present and certainly, we cannot assure that they will come to an agreement. Related to the second point and in the unlikely event that they walked away from the free trade agreement, and that they will have to go for the WTO rules. The maximum duty that our parts will pay is 2.5%, of the parts that we produce in Mexico and are shipped directly to the U.S. In our contracts, we have a very clear statements that our customers know our cost structure very well and certainly if an additional cost will come for us, we will have to pass that cost to our customers. I'm not saying that we have already negotiated those, because first, we have not seen yet any change in that regard. But certainly, that will be our position.

Glenn Zahn

Okay. And just one final question, you mentioned, a little bit of a shock that you have with the -- in Europe with movement away from diesel to gas. Is that effect -- that little shock to volumes that you had, is that drifting into Q1? Or is that just -- you've recovered that?

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

Well, I think that's a very good question, and I like to clarify on that. Certainly, after the Volkswagen diesel scandal that happened a couple years ago, we have seen a shift in Europe that the market is moving from diesel to gasoline. Last year, it went for an about 48% to 42%. So we saw that reduction. We have in Europe, flexibility to move from diesel to gasoline. We have plans that takes a little bit of time to make the necessary adjustments. What we are seeing is that for instance, the reduction that we have already experienced on diesel applications, some of our customers have already been awarded Nemak with some products for gasoline, either heads and blocks, but it takes a little bit of time. We will see in our opinion, an additional reduction in diesel applications and certainly, we are expecting that we will gain, let's say, what we are losing in diesel through gasoline. But certainly, that would have some type of lag, in which we will need to make some adjustment to our production facilities.

Glenn Zahn

Okay, naturally that's all embedded in your 51 million volume guidance for '18, right?

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

That's correct.

Operator

The next question is from Alexandre Falcao with HSBC Global Asset Management.

Alexandre Pfrimer Falcao - *HSBC, Research Division - SVP*

Two questions on the guidance. One, how much you're accounting for structural components in the guidance when you talk about revenues? And the second is, seems like it's a very soft number that you guys are providing in terms of EBITDA and the profitability. Just wanted to know, how much of the effect of the metal lag you guys putting into this thing and what's the upside to this number?

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Yes, related to structural components and EV's, there we expect 2018 for us to be halfway of the 320, so we expect more or less revenues around $150 million for the year. And as we said, ramping up is happening as we speak, and some of it will happen in 2019. But we are, let's say, most likely halfway in 2018. And Alex, can you repeat your second part of the question?

Alexandre Pfrimer Falcao - *HSBC, Research Division - SVP*

Second part is on -- seems like you guys took a very conservative stance on the EBITDA numbers, whatever you look at it. Are you guys factoring in the metal lag here and the guidance? And what's -- and what's the upside to this number?

Armando Tamez Martínez - *Nemak, S. A. B. de C. V. - CEO*

Alex, that's a good question. Certainly, as I indicated, we are providing all of you our best view on how do we see the year. Certainly, as a management team, we will do best efforts to improve in every single item that we can. But at this point in time, that is our guidance and I think we will like to build also credibility.

Alexandre Pfrimer Falcao - *HSBC, Research Division - SVP*

Okay. Okay, perfect. Can you just, if I may insist on this point specifically, I'm assuming that you're having a fairly negative view on the effects of aluminum prices for 2018, right?

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Well, I mean, we saw what happened in 2017 so there's a lot of speculation, yes. So it's hard to put a number.

Operator

(Operator Instructions) Our next question come from Erik McKee with Lazard.

Erik McKee - *Lazard Asset Management LLC - Director, SVP, Portfolio Manager, and Analyst*

Could you tell us, how many million equivalent units you sold in EV plus structural components last year? And maybe expected this year? And also, you had a very high interest expense in 4Q, is that sort of a one-off? Or what are you expecting to spend in interest expense going forward?

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Yes, related to the structural components, let me put it in revenue wise, we had about $100 million of structural component sales in 2017. And as we highlighted in 2018, which should be around $150 million, so halfway through. So there is already activity in structural components in '17, though it's obviously on the nascent phase. Most of that happened in Europe, and a little bit launching in North America with the Q5, for Audi. And then, sorry can you repeat your second question?

Erik McKee - *Lazard Asset Management LLC - Director, SVP, Portfolio Manager, and Analyst*

Can you give us your unit sales per...

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Yes. No, absolutely, no, that's an extraordinary effect. That's a combination of two things. On one side, we had certain leases, financial leases that we had to move on to -- that we, let's say, classified as -- certain leases that were classified as financial leases that had an effect in the fourth quarter. There was most of it was a yearly effect, that was associated to that. The second one is, we have had a little bit of extra interest expenses associated with the euro bond. As we repaid a little bit of the syndicated loans earlier in 2017 with this euro denominated loan, and we have seen the euro appreciated, it was a little bit higher interest expense than what we have before -- that accounts for the effect. You should see interest expense normalizing in 2018.

Erik McKee - *Lazard Asset Management LLC - Director, SVP, Portfolio Manager, and Analyst*

Okay. You can't give us any volume information on structural components and EV?

Alberto Sada Medina - *Nemak, S. A. B. de C. V. - CFO*

Well volume-wise, I think, since it's a little bit different in nature, we are not providing that number directly. I think for now it's better to use revenue as a reference.

Operator

There are no further questions at this time. I'd like to turn the conference back over to Mr. Althoff for any additional or concluding remarks. Sir?

Adrian Althoff

Thank you, operator. I would just like to thank everyone for participating in today's call. Please feel free to contact us if you have any follow-up questions or comments. Have a good day.

Operator

This concludes today's conference. We thank you for your participation and have a great day.
