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## PRESENTATION

**Operator**

Good morning, everyone, and welcome to Nemak's First Quarter 2019 Earnings Conference Call. Armando Tamez, Nemak's CEO; Alberto Sada, CFO; and Adrian Althoff, Investor Relations Officer, are 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.

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**Adrian Althoff** - *Nemak, S. A. B. de C. V. - IR Officer*

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 business and financial highlights from the quarter as well as an update on strategy execution. Alberto Sada, our CFO, will then discuss our financial results in more detail. Afterwards, we will 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.

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

Thank you, Adrian. Hello, everyone, and welcome to Nemak's First Quarter 2019 Conference Call. The consolidated results this quarter reflected the many functions behind our 2019 guidance. As a combination of less stable product mix and lower light vehicle sales and production among certain customers affected the (inaudible) across the regions.

Variation between the U.S. dollar and the euro also put pressure on our results. On the positive side, we've made continued progress in the execution of cost-cutting reduction initiatives, helping us to mitigate the impact of volume-related effects, particularly in Europe.

Summarizing our regions. We saw slightly softer headwinds in North America than we had initially anticipated. While in Europe, we leveraged the efficiencies I just mentioned to deliver improved year-over-year results, absent foreign exchange effects, more than compensated for volume effects in the region. The rest of the World was affected by China, where we extended seasonal work stoppages in response to weaker customer demand.

Taking into account the above-mentioned factors, revenues and EBITDA amounted to $1.1 billion and $175 million, respectively.

I would now like to move on to strategy execution, which was marked by new business opportunities in propulsion applications as well as increased launching activities related to the structural and electric vehicle components. Continual support of customer efforts to deliver improved vehicle efficiency and performance, I am pleased to share that we won contracts this quarter worth a total of approximately $200 million in annual revenues, half of which represented incremental business. The main highlights were contacts to produce engine blocks in all our regions as well as cylinder heads, featuring our patented Rotacast technology, which we believe offer superior mechanical properties and quality performance across a variety of mass-market and high-performance applications.

At the same time, we advanced with more than a dozen new product launches in our structural and EV component segments, most of which are expected to reach peak production levels by 2021. These included: recently awarded business to provide assemblies for battery housings and body-in-white components; to use proprietary casting technology to produce complex electric model housing with integrated cooling features; and to produce our first prototype of cast structural parts in China, among other highlights.

We continue to tap into cross-regional and cross-functional teams, expanding design engineering, casting, joining and assembly, and secondary operations such as machining, among other areas. To drive these efforts towards completion, in particular, I would like to highlight our progress in the startup of the new battery housing business we announced this past February. In addition to finishing the initial design phase, we kicked off the construction of our process and design at the site in Monterrey, Mexico. The battery housing consists of a 3 by 1.5 meter structure of aluminum and steel parts, mainly stamping and extrusions, which will be joining together using state-of-the-art robotic welding, drilling and riveting technologies. This product represents our entry into fully assembled solutions for all electric applications.

As we mentioned in our previous conference call, we expect that our current lineup of structural and EV product launches will collectively emerge as a key catalyst for volumes in subsequent years. I would also like to emphasize that we are making extensive use of existing capacity for these parts, helping us to optimize upfront investment and therefore, not compromising free cash flow generation.

During the quarter, these efforts consisted mainly of adapting lines previously dedicated to traditional combustion engine applications to produce chassis components as well as hybrid transmission housings. Taking into account our global footprint, portfolio casting technologies and CapEx discipline processes, we believe that we are well-positioned to ramp up our backlog of awarded business in structural and EV components in the coming years, which is worth approximately $600 million in annual revenues, all while keeping total CapEx below the average level of the past 5 years.

With this, I conclude my remarks and I will now hand over the call to Alberto.

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

Thank you, Armando, and good morning, everyone. I will share some additional information on our performance during the quarter and expand on Armando's comments regarding industry trends.

As Armando indicated, volumes were influenced by evolving conditions in our main markets. Whereas the overall industry environment in North America remained stable, characterized by continued economic strength in the U.S., Europe saw increased headwinds as a slowing economy affected by Brexit and a slowdown in Eastern Europe, together with new emissions testing standards, hindered light vehicle sales and production.

In the quarter, SAAR for U.S. vehicle sales was 17.0 million units or 1.2% lower year-on-year supported by stable industry conditions, as I just mentioned. Regarding vehicle production, first quarter '19 figures for North America remained basically unchanged for Nemak customers as well as the industry as a whole.

In Europe, first quarter vehicle sales SAAR was 20.5 million units, down 2.8% year-on-year, mainly due to industry-related headwinds. For the same reasons, vehicle production and Nemak's customer production in the region decreased 5.1% and 6.5%, respectively.

Consolidated revenues were $1.1 billion, an 11% reduction year-on-year due mainly to the combined effect of lower volumes and the depreciation of the euro against the U.S. dollar. In turn, consolidating operating income was $91 million, 15.7% lower than last year. The main reasons for this decrease were the volume and foreign exchange effects I just described, which more than offset positive effects associated with operational efficiencies and the adoption of the new IFRS 16 accounting standards for leases. As you may know, under the new IFRS rules, we must recognize operating leases in assets and liabilities. We recognized in the quarter an amount of $67 million of liabilities and intangible assets which will be amortized over the life cycle of this contract. At the same time, the adoption of the IFRS rule resulted in lower operating expenses but increased amortization and financial expenses, which resulted in a net increase in operating income of $4 million in the quarter.

Our EBITDA was $175 million, a decrease of 11% year-on-year due to the same factors explained in operating income. EBITDA per equivalent unit was $14.5, down from $15 in the same period last year. This reduction was mainly a result of the effect in operating income I just described. In particular, the effect of the depreciation of the euro against the U.S. dollar representing about 80% of this gap. Net income amounted to $58 million, a decrease of 15.9% over the first quarter last year mainly due to the combined effect of lower operational income, lower financial cost and higher deferred taxes attributable to the function of currency effects.

CapEx was $96 million in the period, consistent with our expectations of a CapEx reduction for the full year. Our financial condition remains healthy, characterized by a solid cash flow generation, strong financial ratios and no meaningful debt maturities in the near term. Net debt-to-EBITDA was 1.8x. Interest coverage was 9.4x, better than the 1.9 and 8.4x recorded in the same period last year. This marked Nemak's 22nd consecutive quarter with a net debt-to-EBITDA ratio of less than 2x.

Moving on to our regional results. In North America, we had a 6.6% decrease in volume, reflecting a less favorable product mix and lower exports to China. As we mentioned during our discussion in the 2019 guidance, this year we're expecting an increase in sales to I4 applications as opposed to V6 engine applications, which is having a negative effect on volumes, plus effects of the phaseout of certain exports from North America to China. In turn, lower volumes and lower unit prices resulted in a 9% reduction in revenues in the North American region.

EBITDA for the quarter was $109 million, 10% lower than the same period of last year. This was mainly due to the lower volumes, to lower volumes at our operations in Mexico and slightly higher energy costs.

In Europe, we had a 7% decrease in volumes during the first quarter mainly due to a reduction in vehicle production among certain customers. Revenues were down 11% mainly due to volumes and the depreciation of the euro against the dollar. However, good performance at our plants plus efficiencies enabled us to mitigate these headwinds. Excluding the exchange rate effect, EBITDA in the region would have been approximately 3% higher year-on-year.

Turning to Rest of the World. Volumes for the region were down 17% mainly due to lower volumes in China. Whereas in China, we continued seeing the effects of lower sales from Ford as well as industry-wide headwinds. Volumes in Brazil remain stable. Revenues were down 20% affected by lower volumes in China. And for the same reason, first quarter of '19 EBITDA was $7 million lower than the same period last year.

In summary, we continue to build on recent progress with efficiency initiatives particularly in Europe, which help us to partly offset the headwinds I mentioned. But at the same time, leveraging working capital optimization to enhance free cash flow generation.

With that, I conclude my comments. I will now open the call for Q&A. Operator, please instruct the participants on how to place their questions.

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Our first question here is from Luis Miranda from Santander Bank.

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

Alberto, or Armando, good morning, everyone. A couple of questions. Armando, you mentioned in your initial statement, the cost-cutting initiatives and that they were mainly focused in Europe. Could you give us an idea of what are you looking ahead? And if you -- where do you see more opportunities, I guess, by size, it means North America would be the key market where you could extract more efficiencies. But I also want to know if you are seeing any opportunities in the Rest of the World? And if we could expect this division to turn EBITDA positive in the short term? And the second question is, when we take a look at this change in mix from I4 from V6, when do you think that we could start to see a more normalized mix in -- for Nemak? Is this throughout this year or the change in mix could extend towards the end of this year?

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

Thank you, Luis. In terms of cost reduction initiatives, I think as we have always worked in Nemak, we are looking to reduce cost in all regions. I think we are -- as we are moving forward with cost reduction initiatives, based on label reductions in all areas and we are adjusting our organization to the new market reality and we are doing this as quickly as possible in all regions. And the other thing is that we are also looking to save cost in terms of energy, travel expenses, you name it. I think we have a dedicated team. Actually, we are conducting a bi-weekly meetings with all the different business units to make sure that we are making progress. So far, I think it looks positive. You will start seeing better results during the next quarters and we are confident that we will continue reducing cost in every element that we have in our company. Related to the second question on the mix of products, we are seeing definitely a trend in the industry going to downsizing. In the past, certainly, we were enjoying, especially in North America a high percentage of V6s and including also V8s. We have seen a reduction on these 2 type of engines, in mod, let's say, inline engines, which are 4-cylinder and in some customers, even a 3-cylinder. So unfortunately, we don't see that this is going to stabilize. I think this is a trend in the industry. We are seeing that based on regulations to increase fuel efficiency, customers are choosing to have smaller powertrains to propulse their vehicles. So we will not see this effect in terms of mix. We are not expecting that, that is going to change. But having said that, we are working to field some of our open capacity and I think this quarter was a good example in which we were able to get $200 million worth of new contracts, in which half is going to be incremental business. So we are doing our homework internally to use our leverage of technologies and processes to take advantage and also convince some of our customers that this could be a best alternative.

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

Yes, just following up on the first one. Talking with the rest -- regarding the Rest of the World, do you expect any improvement in profitability or marginally in the short term? Or should we get used to a lower-than-expected breakeven operation in the short term?

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

In China, certainly, we are facing some challenges, mainly because some of our -- the North American customers are the ones that have presented a lower demand than we were expecting. I think we already indicated that Ford is, to some extent struggling in that region. They are trying to come with new product lines. By the way, I have seen already 2 new products that they are in the process of launching. Those look attractive. Certainly, we will see how the market will react. We are seeing also the effect on the other 2 North American customers, slight decline on the GM side as well as FCA, that are having some issues with the market there.

In addition to that, the Chinese market for the first time last year went down in sales and production. We started with a very soft first quarter, which at an annual base, was about 24 million compared to the expectation of 27 million. So certainly, we are seeing also that the Chinese government is putting some incentives to promote more consumption in China. Just to give you a little bit more flavor, they've reduced the value added tax from 16% to 13% to try to promote. In relation to that, they reduced the incentive that they were having on electric vehicles to 50% of what they had before, trying to promote the sale of the normal internal combustion engine. So we will see. And in the meantime, we are adjusting our cost structure in China to the new market reality and looking for opportunities to fill some of the open capacity that, unfortunately, some of our lower demand had created. So we are moving forward. And certainly, we expect to recover our profitability in the next quarters in that region.

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**Operator**

(Operator Instructions) Our next question here is from Jose Vazquez from GBM.

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**Jose Vazquez**

My question is regarding, in North America. The previous quarters, you were saying that some of your customers are losing market share. And you didn't mention anything about like that in this quarter. I was wondering if that, the trend stopped and now they are trying to recover all the lost ground?

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

Yes, no. Hi, Jose, this is Alberto. No, what we are seeing for -- what we discussed last quarter was that as a general trend, we were seeing some potential market share drops from our customers in North America. On a full year basis, last year, especially FCA had a fairly good year. They were launching new products. This year, those volumes will be stabilizing. So ultimately, that's going to translate into a little bit of erosion of the market share. So we're still seeing that as a general trend, that was part of what we had incorporated in our guidance. This particular quarter, we didn't see that much of the effect, but we may see that effect moving forward to a certain extent.

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**Operator**

Our next question here is from Alejandro Azar from GBM.

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

The first one is related to IFRS 16. If you can break down -- I don't know if I recall correctly, you said $4 million on depreciation and amortization expenses. Does that include financial expenses? Or could you tell us what are those amounts? And if the guidance of $620 million EBITDA, does that include IFRS 16?

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

Yes. Alejandro, the $4 million that I highlighted on this effect of the new -- the adoption of the new rule, that's the, that's a reduction in operating expenses. So that will be a direct benefit to EBITDA. And part of that is -- or the majority of that is reversed through additional amortization as well as interest expenses per the way the rule works. So and yes, this was already incorporated in our guidance.

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

Okay, perfect. And I have 2 other questions. The first one is related to your buyback program. And since your IPO, you used to have around MXN 500 million for a buyback program. And you used that, but in a very small amount. In the last shareholders' meeting, you increased that to almost MXN 2 billion. Can you tell the rationale on that?

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

Yes. Alejandro. Certainly, as a company, we are always looking to, let's say, protect our shareholders. And certainly, we see that there could be some opportunities. So just as we requested our shareholders to increase the amount from MXN 500 million to MXN 2 million -- MXN 2,000 million, which is approximately a little bit more than $100 million, that we had the opportunity to repurchase shares in the event that we find that it's attractive for the company as well as for shareholders.

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

Okay. And the last one, if you could remind us your quotation pipeline on switchouts and electric vehicle components. Does it still stand at $1.8 billion?

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

Yes. We are seeing a very strong quotation pipeline of approximately $1.8 billion. As we presented in the fourth quarter of last year, we were awarded $400 million to make a total of about $600 million so far. And we are seeing a very strong request from many, many different customers. In this $1.8 billion, I would say that approximately 2/3 are related to EVs and the other 1/3 is to structural components. I think it's important to mention also that we are trying to be very selective in terms of customers and products. We have been working with some of the leading OEMs, moving into electrification, and I think we have made good progress. We are confident that we will continue getting new contracts. And as I indicated, looking for attractive products with high tech entry barriers. And that also, we expect that will convey higher margins and better profitability for the company.

I think it's also important to mention, as I indicated during my comments, that we are trying to reduce open capacity that we have today available. That's our strategy, to try to reduce as much as possible existing assets, to reduce our CapEx for the future, and we have our entire company, our entire management team aligned to try to reduce assets and improve, of course, the return on assets.

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**Operator**

Our next question here is from Augusto Ensiki from HSBC Global Asset Management.

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**Augusto Akihito Ensiki** - *HSBC, Research Division - Latin America Analyst*

I think this already has been answered. Speaking about that open capacity, could you tell us where you guys stand in terms of capacity utilization on a regional basis? So is open capacity strictly Rest of World or is that North America or Europe? Secondly, on the assembly line that you guys are breaking ground on, when does that become ready? Or when is the commissioning of that plant or that assembly line, that it'll become -- or will start producing the components?

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

Yes. Related to open capacity, certainly, we are, as we have indicated in our guidance for this year, we are having lower volume and that has created some open capacity across the regions. We've had open capacity in North America as well as in Europe. And unfortunately, a lot of open capacity today in China, based on the recent market trends with some of our customers. We are targeting -- today we are operating at approximately 80% of all capacity. We normally look to be operating at between 87%, 88%. We have still several million units of open capacity, and that's our main target, to try to reuse these assets. Related to the launching of the new products on the EVs and structural parts, today, we are growing at approximately $200 million worth of revenues for this year and we are expecting that this volume will continue increasing and will peak by 2021, '22.

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**Operator**

(Operator Instructions) Our next question here is from Guilherme Mendes from JPMorgan.

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**Guilherme G. Mendes** - *JP Morgan Chase & Co, Research Division - Research Analyst*

Just a follow-up on the guidance for the year. I just wanted to make sure that after this almost 16% margin you posted on the first quarter, if there's some upside risk for the 14% margin you expect for 2019 as a whole?

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

Yes. Hi, Guilherme. No, we are not anticipating any adjustment on the guidance. So far, the same guidance is what we're seeing after our yearly results. For certain we'll keep pushing.

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**Operator**

Our next question is from Mauricio Serna from UBS.

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**Mauricio Serna Vega** - *UBS Investment Bank, Research Division - Analyst*

Just a couple of things. Just want to ask if you could remind us on the latest number regarding the backlog for the structural components and electric vehicles business. And also you made a comment a little bit more about the North America volumes. I know you mentioned something about an unfavorable mix. And if you could maybe elaborate a little bit more about that? And do you expect that adjustment to continue taking place throughout this year?

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

Yes. Thank you, Mauricio. The first part of your question is related to the backlog. We have already been awarded approximately $600 million worth of EVs as well as structural components. And we continue, as I already mentioned, with a very strong quotation pipeline. We are confident that we will reach the contracts of at least $1 billion by 2022. And certainly, we are confident that we will achieve that. And as I already mentioned, being very selective with the customers, with the regions, as well as the products that we are selling.

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

And Mauricio, related to your question about the volume effects that we're seeing in North America, and this is in line with what we described on the last call, related to the change in mix that we're seeing in the region. We're seeing some more, the lineup of new introduction of I4 engines, that is, unfortunately unfavorable to the total head demand that we are seeing versus V6s. This is a one time effect that we see in '19 and that's aligned with this launching of new engine products and new vehicles that are using the smaller engines. So we see that stabilizing after the 2019 effect. So it's going to be a full year effect but we will see that moving in that direction in the next years.

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**Operator**

Our next question is from Alejandro [Sheppos] , a private investor.

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**Unidentified Shareholder**

I just wanted to (inaudible) . Two quick questions. One is regarding the volume, why is the bidding was that -- direction, now that you mention. I don't know, it's something related to volume, perhaps. But I would say that volume-wise (inaudible) from a couple of years ago, that's not your, call it, priority because you have a lot of demand from call it, (inaudible) pillars or other type of component. Perhaps you have changed a bit in that view? And the second one is perhaps an update on how is the current utilization of the structural and electric vehicles lines, operational lines, how is the current utilization, and how will the ramp up look like in terms of utilization percentage?

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

Alejandro, unfortunately, the line is not very clear and we couldn't hear the first question, it was a little bit long. Could you simplify it a little bit more, just to understand exactly what was your question in the first one?

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**Unidentified Shareholder**

Yes, no problem. So from a couple of years ago, I remember that body-in-white applications were not your core priority, and that now I see that you're in the process of establishing production lines for this. Or is it like a change in how you look at body-in-white applications? Or is it just business as usual?

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

Thank you, Alejandro. I think that's a great question. And you're absolutely right. We announced a couple of years ago that body-in-white was not, let's say, the segment that we wanted to participate. And the main reason for that was because one of the parts that our customers are asking us to quote were not as technically challenged or demanding as the ones that we are now quoting and gaining some new contracts. We had, with the, of the technical background and technology and different processes that we have available, worked with customers to create some parts in which we can take advantage of technology and design, along with the customers, some parts that are very complex. And certainly, that fit right into our strategy. We are moving into that. And certainly, we are very selective in the parts that we are choosing to quote and participate. One recent example was one part that we were awarded and one of our customers, that is a very challenging and very demanding part.

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

And related to your -- the second part of your question, related to the utilization of our lines. Right now, we are in the launch and ramp up of this type of components. If you recall, we had sales last year of about $150 million. This year, we are a little bit less than $200 million. So as we speak, we're building up capacity for this type of product. So I think a little bit too early to have a clear indication of capacity utilization. We're in that process of selling off that capacity for these products.

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**Operator**

Our next question here is from Jose Vazquez from GBM.

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**Jose Vazquez**

Armando, Alberto, again, me. I just have one question. Seeing that you have new contracts for the, your core business this quarter, I was wondering how much percentage are you speaking, how much of the business is due to, for renovation right now or on the expectations for further increasing new contracts on the blocks and heads business?

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

Yes. From these contracts, it's about half-and-half. Half of this $200 million was replacement business. So this is renovation of existing lines. The other half is incremental business, which we will be seeing more and more replacement business materialize.

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**Jose Vazquez**

Okay. So you see more materializing. And are there any platforms that are coming to an end soon this year? Or they're -- most of them are covered for the rest of the year?

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

No. Traditionally, these are projects that the OEMs source at least 2 or 3 years in advance. So this is in anticipation of the normal renewal rate that we're expecting for this type of product. So what we are gaining as contracts in this type of business we will be seeing ramping up in the next 2 to 3 years.

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**Operator**

(Operator Instructions) If there are no further questions, I'd like to turn the floor back to Mr. Althoff for any closing comments.

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**Adrian Althoff** - *Nemak, S. A. B. de C. V. - IR Officer*

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.

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

Thanks.

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**Operator**

-- this concludes today's teleconference. You may disconnect your lines at this time. Thank you again for your participAtion.

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