

NEMAK

Company Note

January 15, 2019

Focused on electric vehicles & structural parts

- In 2019, Nemark would benefit from higher volumes in Europe and improved profitability in Nafta, in view of the favorable effect of a strong USD on the company's cost structure
- Moreover, cash flow generation should continue to support the distribution of attractive dividends. Our estimates assume a 7.1% dividend yield (87% of net income)
- We introduce our PT 2019 of MXN\$ 17.00 per share, implying a 5.5x 2019E EV/EBITDA multiple, similar to the current one and the 3-year average. Given the potential return, our rating is BUY

One of the few companies that benefits from the exchange rate depreciation. We have fine-tuned our estimates after incorporating the new USD/MXN trajectory forecasted by our Fixed Income and FX Strategy department, as well as the most recent vehicle production estimates by IHS. We expect that volume growth in Europe and the Rest of the World would outweigh a NAFTA contraction, while lower volatility in aluminum should be neutral for the company's performance. By contrast, we believe the favorable USD/MXN conversion effect on the company's cost structure in North America, coupled with a better sales mix in Europe, should reflect on improved profitability. Furthermore, we consider that in 2019, Nemark will continue to focus on the growth of its electric vehicles and structural components (EV/SC) business, by closing new contracts. Finally, we have included a higher expectation of interest rates (9.2%e) into our valuation model, yielding a 2019 PT of MXN\$ 17.00, which equals a 5.5x EV/EBITDA multiple, similar to the current level (5.4x). In view of the potential return (included a 7.1%e dividend yield), we reiterate our BUY rating.

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Valentín Mendoza

Auto Parts/ Consumer Discretionary /
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BUY

| | |
|------------------------------|-------------------|
| Current Price | MXN\$15.45 |
| PT 2019 | MXN\$17.00 |
| Dividend 2018 | P\$1.1 |
| Dividend Yield (%) | 7.1% |
| Upside Potential | 17.2% |
| Max – Min LTM (P\$) | 16.48 – 13.02 |
| Market Cap (US\$m) | 2,472.8 |
| Shares Outstanding (m) | 3,079.9 |
| Float | 19.24% |
| Daily Turnover (P\$m) | 25.5 |
| Valuation metrics TTM | |
| EV/EBITDA | 5.3x |
| P/E | 14.0x |

Relative performance to Mexbol

Financial Statements

| MXN, million | 2016 | 2017 | 2018E | 2019E |
|-------------------|--------|--------|--------|---------|
| Revenues | 79,244 | 84,779 | 90,552 | 95,807 |
| Operating Income | 8,684 | 5,767 | 7,127 | 7,820 |
| EBITDA | 14,847 | 13,547 | 13,949 | 15,317 |
| EBITDA Margin | 18.7% | 16.0% | 15.4% | 16.0% |
| Net Income | 5,410 | 3,691 | 3,074 | 4,020 |
| Net Margin | 6.8% | 4.4% | 3.4% | 4.2% |
| Total Assets | 91,892 | 96,690 | 94,018 | 102,052 |
| Cash | 2,661 | 3,757 | 4,089 | 4,278 |
| Total Liabilities | 54,821 | 58,267 | 54,358 | 63,779 |
| Debt | 29,029 | 29,461 | 30,113 | 35,819 |
| Common Equity | 37,071 | 38,423 | 39,659 | 38,273 |

Source: Banorte with data from MSE

Valuation and financial metrics

| | 2016 | 2017 | 2018E | 2019E |
|----------------------|-------|-------|-------|-------|
| EV/EBITDA | 5.0x | 5.4x | 5.3x | 5.2x |
| P/E | 8.8x | 12.9x | 15.5x | 11.8x |
| P/Book | 1.3x | 1.2x | 1.2x | 1.2x |
| ROE | 16.6% | 9.8% | 7.9% | 10.3% |
| ROA | 5.9% | 3.8% | 3.3% | 3.9% |
| EBITDA/ Interest exp | 11.8x | 9.0x | 7.2x | 8.9x |
| Net Deb/EBITDA | 1.8x | 1.9x | 1.9x | 2.1x |
| Debt/Equity | 0.8x | 0.8x | 0.8x | 0.9x |

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Document for distribution among public

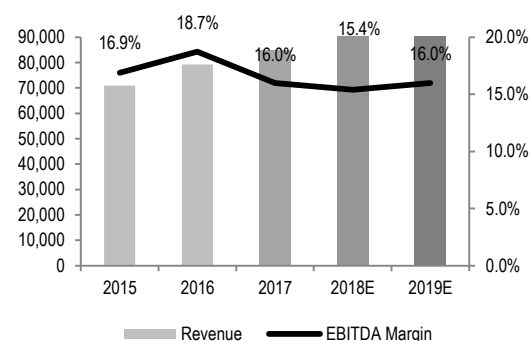
NEMAK—Financial Statements

MXN, million

| Income Statement | | | | | |
|---|-----------------|-----------------|-----------------|-----------------|--------------|
| Year | 2016 | 2017 | 2018E | 2019E | CAGR |
| Net Revenue | 79,244 | 84,779 | 90,552 | 95,807 | 6.3% |
| Cost of goods sold | 65,345 | 71,812 | 77,123 | 81,349 | 6.4% |
| Gross profit | 13,899 | 12,967 | 13,429 | 14,458 | 5.6% |
| General expenses | 4,957 | 5,818 | 6,450 | 6,638 | 6.8% |
| Operating Income | 8,684 | 7,015 | 7,127 | 7,820 | 5.6% |
| Operating Margin | 11.0% | 8.3% | 7.9% | 8.2% | |
| Depreciation | 5,694 | 6,320 | 6,776 | 7,497 | 8.9% |
| EBITDA | 14,847 | 13,547 | 13,949 | 15,317 | 6.3% |
| EBITDA Margin | 18.7% | 16.0% | 15.4% | 16.0% | |
| Interest income (expense) net | (1,439) | (1,900) | (2,604) | (2,154) | 6.5% |
| Interest expense | 1,261 | 1,497 | 1,929 | 1,713 | 7.0% |
| Interest income | 49 | 74 | 109 | 230 | 76.3% |
| Other income (expenses) | 3 | 297 | 13 | (131) | N/A |
| Exchange Income (loss) | (230) | (774) | (797) | (539) | -16.5% |
| Unconsolidated subsidiaries | 55 | 60 | 144 | 77 | 13.3% |
| Net Income before taxes | 7,300 | 5,175 | 4,668 | 5,743 | 5.3% |
| Provision for Income taxes | 1,890 | 1,484 | 1,594 | 1,723 | 7.8% |
| Discontinued operations | | | | | |
| Consolidated Net Income | 5,410 | 3,691 | 3,074 | 4,020 | 4.4% |
| Minorities | | | | | N/A |
| Net Income | 5,410 | 3,691 | 3,074 | 4,020 | 4.4% |
| Net Margin | 6.8% | 4.4% | 3.4% | 4.2% | |
| EPS | 1.756 | 1.199 | 0.998 | 1.305 | 4.3% |
| Balance Sheet (Million pesos) | | | | | |
| Total Current Assets | 104,023 | 106,876 | 116,523 | 118,841 | 4.5% |
| Cash & Short Term Investments | 27,976 | 35,596 | 40,279 | 37,647 | 10.4% |
| Long Term Assets | 183,908 | 188,379 | 193,009 | 211,379 | 4.8% |
| Property, Plant & Equipment (Net) | 136,350 | 134,963 | 140,204 | 158,574 | 5.2% |
| Intangible Assets (Net) | 1,919 | 1,995 | 1,882 | 1,882 | -0.6% |
| Total Assets | 287,930 | 295,256 | 309,532 | 330,220 | 4.7% |
| Current Liabilities | 93,957 | 107,828 | 127,849 | 136,098 | 13.1% |
| Short Term Debt | 614 | 449 | 316 | 336 | -18.2% |
| Accounts Payable | 65,558 | 80,099 | 91,579 | 97,488 | 14.1% |
| Long Term Liabilities | 26,947 | 27,894 | 29,854 | 30,071 | 3.7% |
| Long Term Debt | 14,681 | 14,603 | 15,463 | 15,679 | 2.2% |
| Total Liabilities | 120,904 | 135,722 | 157,703 | 166,168 | 11.2% |
| Common Stock | 167,026 | 159,534 | 151,829 | 164,052 | -0.6% |
| Non-controlling interest | (0) | | | | -100.0% |
| Total Equity | 167,026 | 159,534 | 151,829 | 164,052 | -0.6% |
| Liabilities & Equity | 287,930 | 295,256 | 309,532 | 330,220 | 4.7% |
| Net Debt | (12,681) | (20,544) | (24,501) | (21,632) | 19.5% |
| Cash Flow (Million pesos) | | | | | |
| | 2016 | 2017 | 2018E | 2019E | |
| Cash Flow from Operating Activities before Taxes | 29,045 | 9,511 | 24,610 | 64,292 | |
| Cash Flow from Operating Activities | 36,114 | 24,731 | 27,687 | (12,568) | |
| Cash Flow from Investing Activities | (13,487) | 3,923 | (17,484) | (22,142) | |
| Cash Flow from Financing Activities | (30,523) | (44,366) | (26,541) | (32,215) | |
| Change in Cash Balance | 21,149 | (6,201) | 8,271 | (2,632) | |

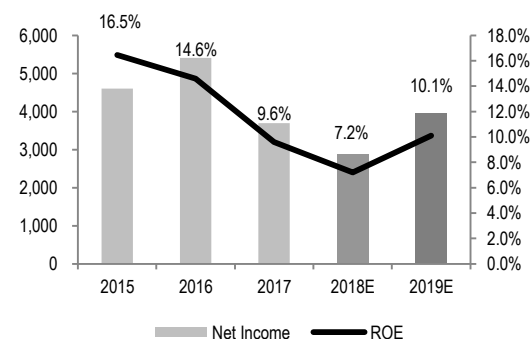
Revenue & EBITDA Margin

MXN, million



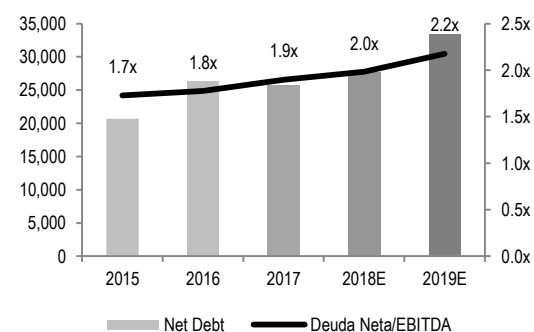
Net Income & ROE

MXN, million



Net Debt & Net debt to EBITDA ratio

MXN, million



Source: Banorte, MSE.

Production in North America is expected to remain flat. IHS, the most widely-known company for automotive research and analysis, estimated that vehicle production in NAFTA will remain practically unchanged in 2019 (-0.1%) to total 16.974 million units. However, it anticipates that production of the 3 largest manufacturers in Detroit will continue to fall (F -8.8%; GM -5.2%; and FCA -1.7%), where it is worth noting that the company holds elevated exposure: (a) Ford North America represents ~24% of Nemark sales; (b) while GM rises to around 13% in this region; (c) FCA, 11%; and (d) other brands contribute with 6%. On the other hand, it expects vehicle manufacturing in Europe to climb 1.1% to 22.23 million. In turn, it considers that performance in China will once again turn positive, with an estimated 2.2% yoy annual growth. Finally, IHS believes that production in Latin America could post a 5.7% year-on-year rally.

2019 Estimates.

We estimate Nemark will achieve a volume of 51.2 million equivalent units in 2019, representing a 1.2% year-on-year increase over our 50.6 million expectation in 2018. We consider that the performance in Europe (+3.0%) and the Rest of the World (+10.0%) could offset the NAFTA contraction (-1.2%), as we believe the change impact in production towards gasoline engines in Europe will have finally dissipated, assuming an easy comparative basis for the company, considering the estimated growth on the production of vehicles. Moreover, we anticipate that a growing demand of Chinese car makers aiming to lighten the weight of their cars, combined with the expected recovery of said industry and that of Latin America, should be the catalysts of double-digit expansion in said region. Finally, in North America, we believe that production growth from several new contracts could partially compensate weak demand of the 3 largest manufacturers in Detroit, with which the Company's volume could drop more than the industry.

In terms of aluminum, the Bloomberg consensus projects a 9.1% yoy appreciation in the price of the base metal (over the year-ago average), closing 2019 at US\$ 2.1 per metric ton. However, the latter would drive the average price per unit by only 0.8% yoy on average, posting a higher effect during the second half of 2019. Consequently, we estimate an average price per unit of US\$93 (+0.8%), leading total revenue to stand at US\$ 4.8 billion (+2.0% yoy). In addition, a favorable 3.8% FX conversion effect on average, explained by an estimated MXN depreciation over the USD towards \$21.30 by year-end 2019, would boost the indicator 5.8% in pesos to MXN\$ 95.8 billion.

Meanwhile, regarding EBITDA, we project a 60 bp-recovery on the corresponding margin to stand at 16.0%. Accordingly, EBITDA is expected to grow 5.9% year-on-year to US\$ 769 million (+9.8% in pesos to MXN\$ 15.3 billion). Such performance would be attributed to the following: (1) a favorable USD/MEX conversion effect on the company's cost structure in NAFTA, as ~36% of its total production is carried out in Mexico (such as labor paid in Mexican Pesos) and the cost of employee benefits represent around 20% of the firm's sales costs; (2) a more favorable sales mix in Europe with greater sales of highly complex products such as EV/SC; and (3) the

absence of negative effects due to the backwardness in the transfer of aluminum price variations towards clients. Moreover, on a net basis, we expect an MXN\$ 4.0 billion benefit (+30.8% yoy), explained by growth in operations and a 17% lower Net Interest Expense (from lower exchange losses), as well as by the benefit of a lower effective tax rate (30%e vs 34.1%e in 2018). On the other hand, we expect the company to disburse US\$ 413 million or MXN\$ 8.2 billion in CAPEX (+5.5% yoy). Finally, we believe the company could require around MXN\$ 5.7 billion in short-term debt to finance working capital, thus elevating the leverage to 2.1x ND/EBITDA in 2019 from 1.9x in 2018E.

Valuation and an MXN\$17.00 2019 PT

We have set our 2019 PT at MXN\$ 17.00 per share. Our PT represents a potential 17.2% yield (7.1%e per dividend), thus we reiterate our BUY rating. At this level, Nemark would trade at 5.5x EV/EBITDA 2019E, similar to the current multiple and to the past 3-year average of the 12m *forward* multiple (both at 5.4x), and on the same level as comparable companies (5.5x). In our DCF valuation model, we used a 9.8% WACC, which was estimated with a 0.8 Beta, a 9.2% Risk Free rate (the 10-year Mexican bond estimate), a 5.5% market premium and the residual value was estimated using a 4.5x EV/EBITDA exit multiple, similar to the median of comparable peers.

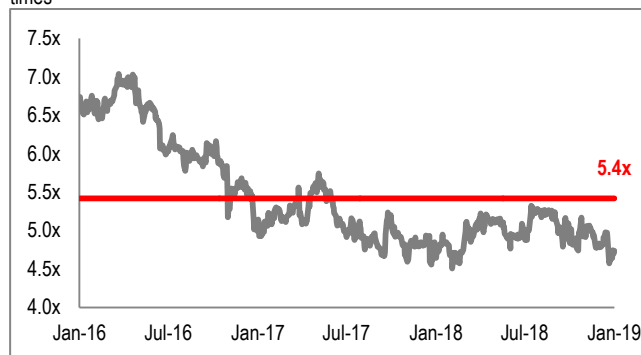
| DCF | | | | | | |
|--------------------------------|---------|---------|---------|---------|----------|----------|
| MXN, million | | | | | | |
| | 2019e | 2020e | 2021e | 2022e | 2023e | 2024e |
| (+) EBITDA | 15,317 | 18,084 | 18,807 | 19,560 | 20,342 | 21,156 |
| (-) Changes in Working Capital | (224) | (984) | (1,128) | (1,174) | (1,221) | (1,269) |
| (-) Capex | (8,253) | (8,300) | (8,881) | (9,503) | (10,168) | (10,880) |
| (-) Taxes | (1,008) | (1,148) | (2,257) | (2,347) | (2,441) | (2,539) |
| (=) Free Cash Flow | 5,833 | 7,652 | 6,541 | 6,536 | 6,513 | 6,468 |
| (+) Perpetuity | 0 | 0 | 0 | 0 | 0 | 94,143 |
| (=) Total Free Cash Flow | 5,833 | 7,652 | 6,541 | 6,536 | 6,513 | 100,612 |

| YE19 | | | |
|--------------------------|--------------|--------------------------------|----------|
| Risk-free Rate (RF) | 9.2% | (+) Cash Flow s' Present Value | 25,893 |
| Equity Risk Premium (RM) | 5.5% | (+) Perpetuity's Present Value | 59,101 |
| Beta | 0.8 | = Enterprise Value | 84,994 |
| CAPM | 13.7% | (-) Net Debt | (31,541) |
| Cost of Debt | 4.6% | (-) Non-controlling Interest | 0 |
| Tax Rate | 30.0% | (+) Other Investments | 0 |
| Net Cost of Debt | 3.2% | (=) Equity Value | 53,453 |
| Debt / Capitalization | 37.9% | Shares Outstanding | 3,080 |
| WACC | 9.8% | Price Target MXN\$ | 17.36 |
| Exit multiple FV/EBITDA | 4.5x | | |

Source: Banorte

Nemak- FV/EBITDA forward 12m

times



Source: Bloomberg, Banorte

RELATIVE VALUATION

| STOCK | P/Book | P/E | P/E 2018E | P/E 2019E | EV/EBITDA | EV/EBITDA 2018E | EV/EBITDA 2019E | DIVIDEND YIELD |
|------------------------------------|--------------|--------------|--------------|--------------|--------------|-----------------|-----------------|----------------|
| ALFA S.A.B.-A | 1.8x | 15.5x | 11.4x | 10.7x | 5.8x | 5.6x | 5.3x | 2.6% |
| GRUPO KUO SAB DE CV-SER B | 1.8x | 21.3x | 14.5x | 11.8x | 7.5x | | | 1.6% |
| GRUPO INDUSTRIAL SALTILLO | 0.8x | 7.4x | | | 6.5x | 6.2x | 5.4x | 3.9% |
| RASSINI SAB DE CV - A | 2.1x | 8.9x | 5.5x | 5.0x | 4.3x | 4.3x | 4.3x | 6.4% |
| CONTINENTAL AG | 1.5x | 8.6x | 8.9x | 8.6x | 4.5x | 4.7x | 4.4x | 3.6% |
| AISIN SEIKI CO LTD | 0.8x | 7.7x | 8.6x | 8.0x | 3.6x | 3.7x | 3.5x | |
| FISCHER (GEORG)-REG | 2.7x | 12.1x | 11.8x | 11.8x | 7.4x | 7.2x | 7.4x | 2.7% |
| RHEINMETALL AG | 1.8x | 12.8x | 13.1x | 11.9x | 5.9x | 5.8x | 5.6x | 2.1% |
| LINAMAR CORP | 0.9x | 5.4x | 5.5x | 5.1x | 4.5x | 4.4x | 4.2x | 1.0% |
| ELRINGKLINGER AG | 0.6x | 8.5x | 8.6x | 7.1x | 5.7x | 5.9x | 5.5x | 6.6% |
| AMERICAN AXLE & MFG HOLDINGS | 0.8x | 3.4x | 4.0x | 4.3x | 4.2x | 4.2x | 4.2x | |
| KAISER ALUMINUM CORP | 2.1x | 18.8x | 15.3x | 12.9x | 9.3x | 8.7x | 7.7x | 2.3% |
| CHONGQING LANDAI POWERTRAI-A | 2.2x | 36.9x | | | | | | 0.8% |
| S&T MOTIV CO LTD | 0.5x | 8.9x | 7.1x | 7.3x | 3.8x | 3.6x | 3.2x | 3.4% |
| MARTINREA INTERNATIONAL INC | 0.9x | 5.3x | 5.3x | 4.8x | 3.6x | 3.6x | 3.4x | 1.5% |
| RYOBI LTD | 0.7x | 7.4x | 7.8x | 7.1x | 4.0x | 5.0x | 4.2x | 2.6% |
| TUPY SA | 1.3x | | 12.1x | 10.6x | 6.2x | 5.6x | 5.0x | |
| CONSTELLIUM NV- CLASS A | | | 5.9x | 6.8x | 4.1x | 5.6x | 5.2x | |
| TOWER INTERNATIONAL INC | 1.8x | 6.5x | 6.5x | 6.6x | 3.9x | 3.6x | 3.6x | 1.9% |
| S&T DYNAMICS CO LTD | 0.3x | | | | | | | |
| FEDERAL-MOGUL GOETZE INDIA | 4.2x | 33.4x | | | 13.3x | | | |
| YUTAKA GIKEN CO LTD | 0.4x | 12.9x | | | 1.5x | | | 3.7% |
| Average | 1.4x | 12.7x | 8.9x | 8.3x | 5.5x | 5.2x | 4.8x | 2.9% |
| Median | 1.3x | 8.9x | 8.6x | 7.3x | 4.5x | 5.0x | 4.4x | 2.6% |
| NEMAK SAB DE CV | 1.4x | 14.0x | 15.5x | 11.8x | 5.3x | 5.3x | 5.2x | 7.2% |
| Premium/ Discount vs median | -4.1% | 10.2% | 73.6% | 42.8% | -3.5% | 2.7% | 7.9% | |

Source: Bloomberg, Banorte

Certification of Analysts.

We, Gabriel Casillas Olvera, Delia Maria Paredes Mier, Alejandro Padilla Santana, Manuel Jiménez Zaldívar, Tania Abdul Massih Jacobo, Katia Celina Goya Ostos, Juan Carlos Alderete Macal, Víctor Hugo Cortes Castro, Marissa Garza Ostos, Miguel Alejandro Calvo Domínguez, Hugo Armando Gómez Solís, Gerardo Daniel Valle Trujillo, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Santiago Leal Singer, Francisco José Flores Serrano, Francisco Duarte Alcocer and Leslie Thalía Orozco Vélez, certify that the points of view expressed in this document are a faithful reflection of our personal opinion on the company (s) or firm (s) within this report, along with its affiliates and/or securities issued. Moreover, we also state that we have not received, nor receive, or will receive compensation other than that of Grupo Financiero Banorte S.A.B. of C.V for the provision of our services.

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Over the course of the last twelve months, Grupo Financiero Banorte S.A.B. C.V., has not obtained compensation for services rendered by the investment bank or by any of its other business areas of the following companies or their subsidiaries, some of which could be analyzed within this report.

Activities of the business areas during the next three months.

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The Analysts of Grupo Financiero Banorte S.A.B. of C.V. do not maintain direct investments or through an intermediary person, in the securities or derivative instruments object of this analysis report.

Guide for investment recommendations.

| | Reference |
|-------------|---|
| BUY | When the share expected performance is greater than the MEXBOL estimated performance. |
| HOLD | When the share expected performance is similar to the MEXBOL estimated performance. |
| SELL | When the share expected performance is lower than the MEXBOL estimated performance. |

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History of PT and Ratings

| Stock | Date | Rating | PT |
|---------|------------|--------|---------|
| NEMAK A | 14/01/2019 | Buy | \$17.00 |
| NEMAK A | 18/04/2018 | Buy | \$16.00 |
| NEMAK A | 14/02/2018 | Hold | \$16.00 |
| NEMAK A | 17/10/2017 | Buy | \$18.50 |

GRUPO FINANCIERO BANORTE S.A.B. de C.V.
Research and Strategy

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Economic Analysis

| | | | |
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Fixed income and FX Strategy

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