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MG.TO - Q4 2017 Magna International Inc Earnings Call

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## PRESENTATION

### Operator

Ladies and gentlemen, thank you for standing by and welcome to the Magna International Fourth Quarter Year End 2017 Results Conference Call. (Operator Instructions) As a reminder today's conference is being recorded, Thursday, February 22, 2018. It is now my pleasure to turn the conference over to Louis Tonelli, Vice President, Investor Relations. Please go ahead, sir.

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**Louis Tonelli** - *Magna International Inc. - VP of IR*

Thank you, Tina. Hello, everyone, and welcome to our fourth quarter 2017 conference call. Joining me today are Don Walker, CEO; Vince Galifi, CFO; and from Detroit Swamy Kotagiri, CTO.

Yesterday our Board of Directors met and approved our financial results for the fourth quarter ended December 31, 2017. We issued a press release this morning for the quarter. You'll find the press release, today's conference call webcast, the slide presentation to go along with the call and our updated quarterly financial review all in the Investor Relations section of our website at [magna.com](http://magna.com).

Before we get started, just as a reminder, the discussion today may contain forward-looking information or forward-looking statements within the meaning of applicable securities legislation. Such statements involve certain risks, assumptions and uncertainties which may cause the company's actual or future results and performance to be materially different from those expressed or implied in these statements. Please refer to today's press release for a complete description of our safe harbor disclaimer.

As you review financial information today please note that all figures discussed are in U.S. dollars unless otherwise noted. We've included in the appendix reconciliations of certain key financial statement lines for Q4 2017 and Q4 2016 between reported results and results excluding unusual items. The quarterly earnings discussion today excludes the impact of these unusual items. We've also included in the appendix a slide that provides an estimate of our 2017 sales and EBIT margin percent, both consolidated for our new segments reflecting the adoption of the new revenue accounting standard for tooling and pre-production engineering.



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The slide provides 2017 results on the old revenue standard for our new segments and then applies our estimate of approximately \$2.3 billion in reduction of sales. We're working through the impact of the new accounting standard on our 2017 results and expect to provide restated numbers by quarter some time before we report Q1.

Finally just as a reminder to everyone listening that we're hosting an Investor Day in New York City on February 28. The webcast of our event will be available on our website. Please feel free to contact me if you like further details. And now I'll pass the call over to Don.

### **Donald James Walker** - *Magna International Inc. - CEO & Director*

Thanks, Louis. Hello everyone. Let me start off with some highlights from the fourth quarter. I was pleased with our results which were record for sales and EPS. And we also had our record EPS for the full year. We continue to outgrow vehicle production and importantly our equity income increased by more than 90% from last year's fourth quarter to \$88 million, largely reflecting strong growth in the dual-clutch transmissions and GETRAG's joint ventures in Asia. And we returned \$461 million to shareholders in the form of share repurchases and dividends bringing the total for the year to \$1.7 billion.

Other highlights for the quarter include Magna's activities for the Consumer Electronics Show in Vegas unveiling of our 4D high definition ICON radar, the recent launch of our Active Air Dam systems on the all-new RAM pickup truck, business wins with new Chinese automaker NIO and finally the launch of the new G-Class at Magna Steyr.

During the fourth quarter excluding the positive impact of currency and acquisitions net of divestitures our consolidated production sales increased by 3% year-over-year, slightly ahead of the increase in global production of 2%. The outperformance was driven largely by North America. It was down 1% versus a 5% percent decline in production. Europe was up 13% versus a 7% increase in production and rest of the world was up 17% versus a 15% increase in production. Asia was down to 4% versus a 1% increase in production.

The below-market performance in Asia is partly due to a difficult comparison with last year's fourth quarter. For the full year 2017 we far outgrew the Asian market. And based on our outlook we expect to continue this strong performance through 2020. In addition our unconsolidated sales in Asia increased 88% to \$672 million in the quarter excluding acquisitions.

As the pace of technology change and the automotive industry accelerates the Consumer Electronics Show in Las Vegas has become an increasingly important event for Magna to showcase products in electrification, autonomy and mobility for our customers and members in the investment community. Our theme this year was science fiction thinking automotive reality. Attendees who had the option to visit our booth got a glimpse into the car of the future with our LiDAR, our high definition radar through our virtual reality experience in an all new matrix lighting technology.

Leveraging our leadership in bringing power to the wheels we also displayed our e1 concept vehicle. The e1 is a Tesla Model S that we use to demonstrate different electric drive concepts and vehicle integration capabilities. The e1 system consists of highly integrated eDrives in the front and rear axles with the rear axle powered by two motors. By using this innovative approach the e1 achieves superior longitudinal and lateral dynamics with excellent vehicle stability for more safety.

The e-motors are combined with a single-speed reduction gear transmission and an inverter in a very compact package and a number of the OEMs have shown interest in this concept. With an open-for-business mindset Magna also used this time at CES to continue to vet new potential partners, technologies and start-up.

In January we formally unveiled our high definition radar which we have branded ICON radar. This new radar sets the standard for resolution and incorporates advanced technology used in the U.S. military to provide precision detection, extensive range and high resiliency. In addition the technology is naturally tolerant to interference which will become a critical issue as the number of radar enhanced vehicles in the road increases. We are currently coding a number of programs for new business with our ICON radar.



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Magna has been collaborating with Uhnder, a technology start-up in engineering and product development to bring this technology to market in 2019. Our relationship with Uhnder builds on the success we have had in identifying and cultivating early stage technology companies and enhances our reputation as an attractive partner.

With a range of more than 300 meters ICON radar continuously scans the environment 50 times faster than it takes a human to blink an eye and does it in four dimensions, so that's distance, height, width and calculates the speed. Icon radar can detect and track almost 100 times more objects and competitive systems and individuals, individually classifying them. The ability to distinguish objects is critical to enhancement safety features such as autonomous emergency braking and will further the progress towards fully autonomous driving.

Magna showed its growing range of aerodynamic systems at the Auto Show in Detroit last month with an Active Air Dam launching on the 2019 RAM 1500 pickup truck. The air dam deploys automatically to reduce air around the vehicle and provides emissions and fuel economy improvements. It's a first of its kind in high volume vehicle production. Combined with Magna's active grille shutter, the aero system on the 2019 RAM achieves an estimated 7% drag reduction and 1 mile per gallon fuel savings on the highway. Across the RAM truck fleet the active aero system is expected to save an estimated 10 million gallons of fuel annually. The RAM's activator systems are driven by smart actuators and powered systems developed in cross-group collaboration between our Magna Exteriors and Closures units.

In China we are seeking -- we are seeing opportunities emerge to supply traditional players as well as start-ups with the new energy vehicles. As a recent example Chinese start-up NIO launched their ES8 electric SUV in December last year. The NIO seats seven, features a lightweight aluminum body and chassis and comes standard with electric drive systems on the front and rear. Magna's content included the aluminum subframe and rear cradle, the gearboxes for both eDrive systems and the latching system to the side doors and hood. This type of launch is ideally suited for Magna. We were able to apply our full vehicle expertise to help make the vehicle lightweight while helping to efficiently deliver power to the wheels.

Last as you know, for nearly 40 years the Mercedes-Benz G-class have been built in Graz, Austria by Steyr. I'm very proud to say that tradition continues with the new G-Class which was introduced at the Auto Show in Detroit last month. As the sole producer of the G-Class we continue to demonstrate our competencies as a highly flexible and experienced complete vehicle manufacturing partner.

Our team in Graz takes immense pride in their knowledge and skill at making high quality automobiles and we are employing the latest technology to keep the operations efficient and optimized. Since the beginning of G-Class production, more than 300,000 of the iconic vehicles have been produced in Graz. In 2014 the production contract with Daimler and Magna was extended. The plant is now producing more units than ever due to model variations and growing popularity of the vehicle around the world. With that I'll past the call over to Vince.

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### **Vincent Joseph Galifi** - Magna International Inc. - Executive VP & CFO

Thank you, Don, and good morning everyone. Overall we post a strong fourth quarter consolidated results including all-time record consolidated sales of USD 10.4 billion, fourth quarter record consolidated EBIT of USD 809 million which is up 16% over 2016, fourth quarter record net income of USD 568 million, up 13% from Q4 2016 and adjusted EPS of \$1.57, an all-time record for us, up 20%.

We also generated free cash flow after capital and other asset spending of USD 585 million and returned and USD 461 million to shareholders through share repurchases and dividends. Lastly, our board approved a 20% increase in our quarterly dividend. I will cover each of these in my financial review. Our consolidated sales were an all-time quarterly record of USD 10.4 billion, an increase of 12% over the fourth quarter of 2016. European and rest of world production sales, complete vehicle assembly sales and tooling, engineering and other sales were up -- were each up year-over-year.

The higher sales largely reflected the launch of new programs and the USD 418 million positive impact of foreign exchange translation. EBIT margin percent increased to 7.8% in the fourth quarter of 2017 from 7.5% in Q4 2016. The combination of these results resulted in a 16% increase in EBIT to USD 809 million. Year-over-year equity income increase USD 42 million or 91% to USD 88 million in the fourth quarter of 2017 largely reflecting contribution on higher sales due to the launch of new programs and contract in Asia partially offset by launch and related costs at our GETRAG joint venture in Europe.



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Excluding equity income EBIT margin was relatively unchanged at 6.9% in Q4 2017 from 7% in the fourth quarter of '16. This is despite the higher proportion of the European production sales, assembly sales and tool and engineering and other sales all of which typically earn a margin percent below the Magna average.

Looking at EBIT margin percent by segment. North American EBIT margin was 9.6% in the fourth quarter compared to 9.9% in the fourth quarter of 2016. The decline primarily represents final yearend customer settlements, higher new facility costs and detrimental margin on lower production sales partially offset by operational improvements, higher scrap steel recoveries and warranty costs.

European EBIT margin increased to 3.5% in Q4 2017 compared to 2.2% in the fourth quarter of 2016. This increase primarily reflects contribution on higher sales and lower warranty costs partially offset by operational inefficiencies and launch costs at a body and chassis facility, lower equity income and higher commodity costs. If you exclude our complete vehicle assembly business margins in Europe were 4% compared to 2.4% a year ago.

EBIT margin in Asia increases 17.5% from 12.9% in Q4 2016. The increase was primarily due to record equity income of USD 68 million partially offset by a higher proportion of tooling, engineering and other sales to total sales.

Lastly, rest of world incurred a loss of USD 3 million in the fourth quarter of '17 while our full year 2017 adjusted EBIT was USD 12 million compared to a loss of USD 17 million in 2016. Our effective tax rate increased to 26% this quarter, bringing our full year effective tax rate to 25% in line with our expectations before the impact of U.S. tax reform.

Net income attributable to Magna was USD 568 million compared to USD 504 million in 2016, mainly reflecting higher EBIT partially offset by higher taxes. Diluted EPS grew 20% -- or \$0.26 to \$1.57 for the quarter compared to \$1.31 last year. In addition to higher net income the interest reflects a 6% decline in shares outstanding.

I'm now going to review our cash flows and investment activities. During the fourth quarter of 2017 we generated USD 1.4 billion of cash from operations including USD 564 million in noncash operating assets and liabilities. In the quarter investment activities amounted to just over \$1 billion including USD 750 million in fixed assets and USD 267 million increase in investments, other assets and intangibles.

Free cash flow was USD 585 million in the fourth quarter, bringing us to USD 1.2 billion for 2017. In addition, we paid USD 95 million in dividends and repurchased USD 6.7 million common shares for USD 366 million in the fourth quarter. For 2017 we repurchased USD 26.3 million common shares for approximately USD 1.3 billion.

We announced today that our Board approved a 20% increase in a quarterly dividend to \$0.33 per share. This represents the ninth consecutive year of dividend increases reflecting our continued growth in earnings as well as management's and the board's expectations for the future.

Turning to our outlook, we made only one change to what we provided in Detroit last month. We increased European light vehicle production by about 100,000 units to approximately 22.4 million units for 2018. All other elements of our 2018 outlook including our margin percentages by segment are unchanged from the outlook we provided in January.

In summary, in Q4 we set a new all-time quarter sales and EPS records for Magna along with fourth quarter records for EBIT and net income attributable to Magna. We returned USD 461 million to shareholders in the quarter and generated USD 585 million in free cash flow, bringing our 2017 amount to USD 1.2 billion. And we are bringing in new technologies to market driving continued secular growth for Magna.

Before we get to Q&A I'd like to spend a moment discussing our growing equity income. As our outlook suggests, we are expecting a CAGR of 15% to 20% for equity income into 2020 largely driven by joint ventures in Asia. Importantly, we have been converting substantially all of this income to cash in the form of dividends and our conversion rate is expected to remain high.

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Our income statement -- on our income statement equity income is largely after-tax dollars. We are currently trading at an EV to EBITDAR discount to our peers. If you put a P/E multiple on our equity income, our EV to EBITDA multiple would be at an even greater discount to our peers. We are hoping that investors will begin to recognize this.

Thanks for your attention this morning. We'll be pleased to answer your questions.

### QUESTIONS AND ANSWERS

#### Operator

(Operator Instructions) And our first question comes from John Murphy, Bank of America Merrill Lynch.

#### **John Joseph Murphy** - *BofA Merrill Lynch, Research Division - MD and Lead United States Auto Analyst*

A first question just on sort of the some of the slight weakness in North America in the fourth quarter and then as we think about things going into 2018, I was just curious how big an impact the changeover of GM's trucks had in the quarter and how we should think about them through the course of 2018? And I think some of the forecasts for the volumes to be round about flat year-over-year but there's going to be some ebbs and flows in the (inaudible). So I'm just curious if you could give us some color on that and if there are any other big changeovers in the year we should be thinking about?

#### **Vincent Joseph Galifi** - *Magna International Inc. - Executive VP & CFO*

Yes, John, maybe let me start with that and then Louis if you want to talk about the T1XX launch in particular. When I look at the fourth quarter and the cadence of margins, I guess sequentially in the quarter margins were up a little bit, I guess on a quarter-over-quarter basis down. And kind of when I look at what happened in a quarter, if I look at it year-over-year John, the one thing that sticks -- there's lot of puts and takes, higher launch costs, higher new facility costs, there's lower warranty costs and improvements in some of the divisions we were focusing on over the last couple of years. But the one thing that stands out in my sort of quarter-over-quarter analysis is a true-ups at year-end for customer settlements. In the course of the year you're making accruals on LTAs and get backs. And as I looked across the company in North America there's a bunch of true-ups that all went one way. That was negative to kind of our expectations and that was the impact in Q4, so that's going to go away for 2018. So if we look at 2018 for North America, what we thought that we were going to deal with just in Detroit last month is still consistent and our views have not changed.

#### **Louis Tonelli** - *Magna International Inc. - VP of IR*

In terms of the launch of the big truck program our expectations for the year is that it's going to be down, down about 10%, that's our original -- our current planning is. And it's going to be down pretty significantly through the first half of the year and higher than that actually in the first quarter. So it will have an impact in our -- in sort of the cadence of our quarters. (inaudible) is going up. It's a pickup truck that is launching right now (inaudible) 2,100 from about 1,800 (inaudible) overall in the program. So it should be a net positive but there is going to be some impact as we get through 2018.

#### **Donald James Walker** - *Magna International Inc. - CEO & Director*

The only other comment on the launch, it's a huge launch for General Motors and they've had a big focus on this and we have a lot of content -- I think it's 36 plants and Magna impacted by the T1XX. We've done a deep dive in the launches, we've got launches in Cosma, powertrain, our electronics, our closures, our mirrors, lighting. So we've had a big focus on it. We expect everything to go smoothly and it will be important for GM

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and obviously for us to get the launches efficient but it's going to get program going forward. I wouldn't say it was an impact on the fourth quarter so much for us.

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**John Joseph Murphy** - *BofA Merrill Lynch, Research Division - MD and Lead United States Auto Analyst*

Okay. And then just a second question, Don, on CES and all of your technology you've kind of highlighted some new customers. I'm just curious how much interest you are seeing from your nontraditional customers and how big an opportunity set does that sort of open up or -- with these new customers? But also as you were at the CES, were there sort of acquisitions that sort of came across your desk or sort of your thought process for technology that you may commercialize and grow. So maybe on the customer side but also on the potential for acquiring some technology too.

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**Donald James Walker** - *Magna International Inc. - CEO & Director*

Yes, Swamy is in the call, I may turn over to Swamy at the end here because he'll know more of the details. I'm not sure what we're saying publicly. We haven't said a lot of obviously. We had there and we continue to have a lot of discussions with a lot of new start-up companies. It's a really interesting field to be in right now, there's so many people come up with new ideas. We got to look at what do we think is manageable which can be cost competitive. We've looked at auto-qualify and so a lot of really good discussions ongoing. We have seen a lot of interest in the radar and the LiDAR and obviously our vision-based camera systems. We don't typically talk about who we're having discussions with. I'm not sure, but do you want to add anything, Swamy?

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**Seetarama Kotagiri** - *Magna International Inc. - Executive VP, CTO & President of Magna Electronics*

Yes, I think you answered it, John, the only difference is we have specific domains of technology that we're looking that become relevant to the automotive industry and that's how our technology mining goes about. So roughly last, over the last 16 to 18 months we would have looked at about 1,100 different technologies at differ in shapes and forms come through. And we have like 20-plus projects that are active in the, I call it the proof-of-concepts stage, so.

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**John Joseph Murphy** - *BofA Merrill Lynch, Research Division - MD and Lead United States Auto Analyst*

And Swamy, if you were to think about that sort of like 24 months ago I mean how many would have you looked at sort of over the 16 to 18 months prior? I mean how much has that ramped up as far as sort of what you're looking at for acquisition of technology?

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**Seetarama Kotagiri** - *Magna International Inc. - Executive VP, CTO & President of Magna Electronics*

So John, I think in the last 4 to 5 years definitely the pace of acceleration is much higher in terms of the technologies that are coming across. And that doesn't constrain only to the electronic set of things, there's a lot of things coming up in materials like carbon nano tubes, different possibilities in graphene, advanced robotics application for manufacturing and so on. So I would say the pace has accelerated over the last 3, 4 years significantly compared to before that time.

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**Donald James Walker** - *Magna International Inc. - CEO & Director*

We're going to be also be having our Investor Day next Wednesday, so will be giving an update in a number of different areas.



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**John Joseph Murphy** - *BofA Merrill Lynch, Research Division - MD and Lead United States Auto Analyst*

Just real quick lastly on CapEx, I mean it looks like it's going down, it's not going to much year-over-year it's roughly similar in '18 versus '17 but my understanding is the CapEx goes down significantly going forward and I'm just curious if that's still consistent of what you're looking at and is that something that we should expect or will there continue to be sort of this very heavy investment for growth because it seems like you've been doing a lot of that in the last couple years?

**Vincent Joseph Galifi** - *Magna International Inc. - Executive VP & CFO*

Yes, John, if we think about our presentation in Detroit just in the month of January we outlined what our capital plans were and it is coming down a little bit in '18 and we expect capital in absolute dollars to come down or be roughly the same of what we got in '18. But remember, between '17, '18, '19 and '20 the business continues to grow. So if you look at our capital spending as a percent of overall sales we're expecting that to come down. We've had some pretty significant, I call it lumpy capital spending over the last 2 to 3 years and we don't expect that to necessarily repeat itself in the next sort of while. And we're seeing the benefit of that as a reduction of capital as a percent of sales going forward.

**Operator**

Our next question comes from Rich Kwas, Wells Fargo.

**Richard Michael Kwas** - *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

Just on the -- on that -- following up on John's question on the CapEx, so your guidance around percentage of sales coming down is pretty clear. I guess just if we think about the next years in terms of sales growth what could move that number in terms of absolute dollars? Is there enough stuff in the pipeline that you could add by 2020 that would be a material or at least weigh materially on CapEx spend as we think about it or are you pretty comfortable with the outlook even if you're able to add some new programs.

**Donald James Walker** - *Magna International Inc. - CEO & Director*

I'd be pretty comfortable. We've looked at -- we even really highly focused on free cash flow for the last year and a half and we're looking forward. So to the extent we get good opportunities for good returns on investment we want to be doing them. But we have pretty good visibility in '18, '19 even into '20. So if we're going to win some business it's going to be heavy capital. I guess it could be added in '19, sorry in '20, but we have a pretty good visibility what we -- I mean we should know it really clearly in '18, the timing might slip a little bit over the year-end. Even '19 we have pretty clear visibility.

**Vincent Joseph Galifi** - *Magna International Inc. - Executive VP & CFO*

Yes, Rich, I think when you like when I think about our capital plan as you get up to '20, right, remember the plan is bottoms-up based on programs that we have, so as Don said we got clear visibility and these are programs that obviously we think we're going to get and we're pretty confident. But in our 2020 numbers when I kind of put the numbers together there is a placeholder because our experience is there will be programs that we don't have visibility today, they're going to launch in 2022 and 2023 where capital may be required to be spent to 2020. So barring a big significant growth in opportunities I think we're covered for 2020 on the capital side.

**Richard Michael Kwas** - *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

Okay, all right, great. And then on the radar, Don, is that -- so commercially available does that mean that it's going to be in development programs with OEs next year or when would we think about that potentially going into production contract or become part of the production contract?





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**Donald James Walker** - *Magna International Inc. - CEO & Director*

We're at a point where we think we should be landing -- we can land a production contract, it's still in development obviously, but we think we're far enough along. Swamy, you want to give anymore color on it?

**Seetarama Kotagiri** - *Magna International Inc. - Executive VP, CTO & President of Magna Electronics*

Yes, Rich, I think we're actually working on development projects with the OEMs as we speak today. So the target programs that would go into production on a normal production basis would be 2020-2021.

**John Joseph Murphy** - *BofA Merrill Lynch, Research Division - MD and Lead United States Auto Analyst*

Okay. And we should hear potentially something around that in terms of announcement in the next 12 months anyway, ideally?

**Seetarama Kotagiri** - *Magna International Inc. - Executive VP, CTO & President of Magna Electronics*

Yes. I think as we go through the programs, hopefully we'll land a few and then we will talk through it as we get more news.

**John Joseph Murphy** - *BofA Merrill Lynch, Research Division - MD and Lead United States Auto Analyst*

Okay. And then just a clarification. As we think about Q1, I think Vince you referenced it a little bit, but typically you're -- and I know you don't give quarterly EPS guidance, but typically your EPS is flat to down sequentially, kind of with the production discussion around GM trucks, et cetera, that Louis referenced, should we think about being in line, seasonality in line with history or a little bit worse, any color around that?

**Vincent Joseph Galifi** - *Magna International Inc. - Executive VP & CFO*

Yes, Rich, you know what, I -- we haven't really given any color on a quarter-by-quarter basis. There's a lot of moving pieces with T1XX, there's equity income and we'll continue to ramp-up at Magna Steyr. And so I think best is to think about the full year and how that falls in the quarter is maybe lumpy but we'll get our full year numbers by the end of '18.

**Operator**

Our next question comes from David Tyerman, Cormark Securities.

**David Bruce Tyerman** - *Cormark Securities Inc., Research Division - Analyst of Institutional Equity Research*

My first question is on the customer settlements. Could you quantify those Vince?

**Vincent Joseph Galifi** - *Magna International Inc. - Executive VP & CFO*

They are probably in the range of, I'd say, \$20 million to \$30 million in the quarter.



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**David Bruce Tyerman** - *Cormark Securities Inc., Research Division - Analyst of Institutional Equity Research*

And then just for each of the eDrive train and the advanced driver systems, could you give us a bit of an idea of the size of these at this point in terms of revenues? And then what kind of growth rates we're looking at over the next 2 or 3 years?

**Vincent Joseph Galifi** - *Magna International Inc. - Executive VP & CFO*

Yes, in terms of ADAS for 2017, David, we're about \$575 million in sales for '17. In terms of overall growth, I'm not -- I don't have that number right in front of me. I don't know, Swamy, do you have some color on that?

**Seetarama Kotagiri** - *Magna International Inc. - Executive VP, CTO & President of Magna Electronics*

I think we're going to give a little bit more detail in the Investor Day, Vince, I think, but we're looking at the \$1 billion range by 2020-2021. But that's a rough number.

**David Bruce Tyerman** - *Cormark Securities Inc., Research Division - Analyst of Institutional Equity Research*

And the same thing...

**Vincent Joseph Galifi** - *Magna International Inc. - Executive VP & CFO*

(inaudible) strong year 2017, I think we're USD 450 million in 2016, so we got really strong year in 2017.

**David Bruce Tyerman** - *Cormark Securities Inc., Research Division - Analyst of Institutional Equity Research*

Okay. And the same thing on the e-side, the eDrive train, et cetera?

**Vincent Joseph Galifi** - *Magna International Inc. - Executive VP & CFO*

Yes, I think some of that eDrive business that we've got booked today, David, is actually going to flow through equity income down the road and that's really starting in '21-'22 timeframe. So it is beyond kind of our formal guidance to period to 2020.

**Donald James Walker** - *Magna International Inc. - CEO & Director*

We'll give the information as we feel -- as we get it, obviously, and we feel comfortable with it. I think the big unknown is going to be what are the penetration rates of these various eDrive systems by our customers. So what's the timing and what's the volume, and I don't think people really know because it's going to depend on consumer demand, it's going to depend on what if there legislation, price of gas. So we'll have to, and when we give guidance we're going to have to tell you what our assumptions are and then that -- of the penetration rates and that will drive the sales. That's true for us and it's a true for anybody else, quite frankly, in this business, because I don't think anybody really knows what the take rate is going to be. And the volumes on the stuff that we've been doing to this point whether it be the Ford BEV or the Volvo, that's low-volume of business just by the nature of the business. So it's more of a business that's up and coming as opposed to lot of revenues today.

**David Bruce Tyerman** - *Cormark Securities Inc., Research Division - Analyst of Institutional Equity Research*

The last question I had is on GETRAG, sounds like it's doing a lot better in Asia, really growing fast and it sounded like it was negative in Europe, could you just give us some qualitative on what's going on in the 2 regions and how you see them progressing.



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**Vincent Joseph Galifi - Magna International Inc. - Executive VP & CFO**

Yes. So, David, as we look at GETRAG, you'll recall last quarter we made some specific comment on GETRAG Europe and GETRAG Asia. And what we said last quarter is relative to kind of our expectations for Q3 and relative to our expectations previously we thought our Q4 equity income was going to be the \$10 million lower in each of Europe and the Asian segments. And if I look at where we ended up in Q4 for GETRAG on the equity income line in Europe, I think we're a little worse than our expectations and it all relates to some of the launch costs and some of the issues we identified in Q3 and those are relatively behind us. So I think we'll get back to normal pace as we move into 2018. In Asia we were expecting softer volumes which is why we talked about relative sort of reduction in equity income versus expectations. But as the quarter progress sales were stronger than what we thought and our equity income in Asia in GETRAG joint ventures actually came in higher than expectations. So if you kind of look out, the equity income quarter-to-quarter may be a lumpy, but if you think about our equity income in our Power & Vision group and GETRAG is a big part of that, we're expecting just in that group alone equity income somewhere between \$320 million to \$350 million in '18 and that's growing to \$360 million to \$405 million, and most of that -- change in all that growth is through GETEAG. So we continue to expect to see growth in equity income both in Asia and in Europe.

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**Louis Tonelli - Magna International Inc. - VP of IR**

So just to add a little color on that. If you recall last quarter we said that by Q4 we were going to -- it was going to be our highest quarter and it was driven by the launch of the business in Asia. But we were tempering the sale that we expected relative to our previous expectations. As it turns out, we did that based on some of the softening in some of the programs that we've seen on volumes in Q3 and what was forecasted in Q4. Well, it turned out Q4 was pretty strong, sales in the unconsolidated business was very strong and recall that we said that '18 is going to be another strong year and '19 is strong as well. So that trajectory is going to continue to be strong as we go into '18 and '19.

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**Operator**

Our next question comes from Peter Sklar, BMO Capital Markets.

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**Peter Sklar - BMO Capital Markets Equity Research - Analyst**

You haven't talked a little bit or in a little while about there was the one Cosma plant, that was quite a -- obvious drag on North American results about a year ago. Has that plant been fixed or it's just that you've lapsed the bad quarters, so you're not seeing the year-over-year impact?

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**Donald James Walker - Magna International Inc. - CEO & Director**

No, Peter I think in my comments if you think about year-over-year in North America part of the additives to the pluses and minuses, one of the plus was improvements in that facility on a year-over-year basis and that contributed to earnings growth in 2017 in Q4. So it continues to make progress. We continue to see improvements in the facility and we expect that even in 2018 that on a year-over-year basis it's going to contribute more to earnings in '18 versus '17 and '17 was stronger than '16.

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**Peter Sklar - BMO Capital Markets Equity Research - Analyst**

And then in your remarks there is also a Cosma plant in Europe that's underperforming that's impacting results. Is this something new or is this -- have you referred to this before?

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**Donald James Walker** - *Magna International Inc. - CEO & Director*

I think, Peter, we talked about it in last quarter. It's in Europe, obviously, it's -- a lot of launches going on, launches started actually in the fourth quarter of -- third or fourth quarter of 2016. And volumes have been significantly higher than what we had quoted on. So we've been running pretty hard. We've been having some inefficiencies. We've got an action plan in place. So, again, as I look into '18 I think that that's going to contribute to our earnings and margin improvement in Europe in '18 versus '17.

**Peter Sklar** - *BMO Capital Markets Equity Research - Analyst*

And then just 1 last question, Don, if I could ask you, this whole dramatic market shift to truck versus car, I am sure that is something that Magna as a whole thinks a lot about in terms of your quoting where you want to be, I mean do you think this will eventually like the pendulum will shift back or do you look at this more as a permanent change or evolution of the market and not like are you positioning the company to pursue all of these truck programs.

**Donald James Walker** - *Magna International Inc. - CEO & Director*

Well, we have been pretty successful in SUVs and trucks over the last quite a while. I wouldn't want to claim that we're visionaries in understanding the market better than other people. There are things that could (inaudible) but we do have good content. A lot of the products we are working on like weighting, aerodynamics, a lot of the powertrain we have been successful and they are applicable to some of the bigger vehicles. I think the thing that could change it would be if fuel costs go dramatically up. We do not see that. It seems like the preference in North America and China for that matter is on the SUVs, and I am not a marketing expert but I can understand the fuel economy is better, they're more utility usage, I think everybody has their own view on it, but we do not see it dramatically changing and you can see where our customers are really putting their focus and they are not putting as much focus or development cost on the traditional car market other than the luxury end.

**Peter Sklar** - *BMO Capital Markets Equity Research - Analyst*

And sorry, then just 1 last question, how are you seeing manufacturing costs like your cost structure unfolding in China say as you compare it to North America, I mean I think we all know there is cost pressures that are building wage pressures in China. How is the cost structure now in China compared to your North American facilities?

**Donald James Walker** - *Magna International Inc. - CEO & Director*

Well, it's still cheaper in China if you look at the direct labor. I think the -- it depends where you are in China, some of the areas like Shanghai and some of these areas the cost to get engineers, program managers more of the technical people is -- has been and does continue to increase, we're doing more engineering over there. So I do not think there is a huge benefit in some of those costs to Europe and North America but direct labor even though it has going up as percentage of sales it is still substantially lower than what would be seen in North America and Europe. I don't think there is a huge advantage over in China compared to places like some areas in Eastern Europe and Mexico. So what we tend to look at for each of the regions, this sort of goes back to the message we're explaining to everybody NAFTA, each of the regions it is nice to have a location that has a lower cost direct labor so we can be competitive in our systems and nothing has really changed that dramatically there but certainly the higher skilled people going up pretty dramatically in China.

**Operator**

(Operator Instructions) Our next question comes from Colin Langan of UBS.



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**Colin Langan** - UBS Investment Bank, Research Division - Director in the General Industrials Group and Analyst

I just had a clarification. When you look at the Detroit Auto Show presentation assembly sales guidance was 35 to 37 for '17, it came in I think closer to USD 3 billion. Is that just the classification difference for the new segmentation or does it actually come in lighter than expected?

**Louis Tonelli** - Magna International Inc. - VP of IR

I think you're looking at, you're comparing our new segment the 35 to 37 which includes engineering to our complete-to-go assembly business which is just the assembly business. That is the biggest difference if you will between the 2 that you are look at.

**Colin Langan** - UBS Investment Bank, Research Division - Director in the General Industrials Group and Analyst

So it's the inclusion of everything.

**Louis Tonelli** - Magna International Inc. - VP of IR

There was nothing out of the ordinary besides that.

**Colin Langan** - UBS Investment Bank, Research Division - Director in the General Industrials Group and Analyst

And any thoughts on M&A where your kind of priorities would be, whether you would consider something sizeable, is there are any thoughts there, any updates on where you're looking?

**Donald James Walker** - Magna International Inc. - CEO & Director

We're still looking at what the opportunities are. We have the targeted debt, adjusted debt, adjusted EBITDA ratio and we're generating a lot of cash, we talked about that. So we have the ability to do the sizeable acquisition if it makes sense. We have been tending to look at some of the new technologies that are out there but we where have the ability to, and we continue to look at opportunities in the areas that we think are key products for us going forward but we really won't talk much about what we're doing and looking at until we're ready to.

**Colin Langan** - UBS Investment Bank, Research Division - Director in the General Industrials Group and Analyst

And just one last question. I'm sure I missed this in the comments. The underperformance in Asia, you seem to outperform every region, what was the driver there...

**Vincent Joseph Galifi** - Magna International Inc. - Executive VP & CFO

Sorry, can you repeat the question, Colin? Let me just give you some more color on Magna Steyr, just I was looking that up as you were asking your question. So where we came in on complete vehicles is about USD 3.5 billion in 2017. Remember that our basis of accounting is going to change in '18, so the guidance we gave in Detroit was in the new basis of accounting, so even on a consolidated basis we came in at about USD 38.9 billion in 2017. If we apply the new revenue recognition policy, the '17, our consolidated sales no impact, there is hardly any impact to EBIT but our consolidated sales will go down by about USD 2.3 billion. So we would be at USD 36.6 billion. In reference our guidance consolidated USD 39.3 billion to USD 41.5 billion for 2018. So when you look at Magna Steyr on its own on complete vehicles when you actually I think you take in here those engineering as well. On the old basis we were USD 3.7 billion which is consistent to what we were expecting for 2017. If you take the 2017 sales and apply the new revenue recognition policies that is going to apply to '18, the '17 sales are going to be restated to about USD 3.5 billion. And that again is pretty consistent with what we talked about in Detroit. So Colin maybe you can just ask the question again and I will try to answer your second question there.



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**Colin Langan** - *UBS Investment Bank, Research Division - Director in the General Industrials Group and Analyst*

It's just on looking at (inaudible) Asia was the only region where you underperformed the market, just any color on...

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**Louis Tonelli** - *Magna International Inc. - VP of IR*

Sales or margin?

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**Colin Langan** - *UBS Investment Bank, Research Division - Director in the General Industrials Group and Analyst*

Sales, sales.

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**Louis Tonelli** - *Magna International Inc. - VP of IR*

On sales.

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**Vincent Joseph Galifi** - *Magna International Inc. - Executive VP & CFO*

In the quarter?

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**Colin Langan** - *UBS Investment Bank, Research Division - Director in the General Industrials Group and Analyst*

Yes, yes.

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**Vincent Joseph Galifi** - *Magna International Inc. - Executive VP & CFO*

You know what, I think if you look at the entire year we outperformed the market on a consolidated basis, yes, it is really hard on a quarter, if you got mix or anything could impact sales. I wouldn't draw any conclusions from Q4 in particular. I think when you look at Asia for us you also have to think about managed sales, I mean what we've got in consolidated and unconsolidated and there has been growth there. And our Asian sales again I think a better reflection is year-to-year as supposed to quarter-to-quarter.

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**Louis Tonelli** - *Magna International Inc. - VP of IR*

Yes, we did just have it the quarter. We had a couple of our largest programs particularly in China, we're just down relative to the overall market. So we do expect looking at '18 it is going to be strong, the growth, it was strong for the whole year. Just for the 1 quarter we saw couple of our biggest programs were down sequentially or year-over-year and that drove the underperformance on sales.

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**Vincent Joseph Galifi** - *Magna International Inc. - Executive VP & CFO*

Colin, if you think about '18 just in Asia like our guidance is growth in overall consolidated sales of 14% to 15%.

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**Operator**

Our next question comes from David Tamberrino, Goldman Sachs.



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**David J. Tamberrino** - *Goldman Sachs Group Inc., Research Division - Associate Analyst*

I wanted to follow up on the customer true-ups at the end of the year for North America, is this more of a one-off for the end of the year or is this indicative of just a little bit more of a competitive environment and a little bit more price down just for getting towards the end of the cycle here?

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**Vincent Joseph Galifi** - *Magna International Inc. - Executive VP & CFO*

David, it happens every Q4, and you know what when you look at it in those times across the organization it balances out to pretty close to 0 and this quarter it didn't balance out to 0, so, no, I wouldn't take anything of it...

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**David J. Tamberrino** - *Goldman Sachs Group Inc., Research Division - Associate Analyst*

Yes, I mean, that is the reason why I am asking is because you alluded to in your comments earlier that previously not all of them would go one way but this year it happened to do it, but...

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**Donald James Walker** - *Magna International Inc. - CEO & Director*

I don't think there is anything unusual, but it is always pricing pressure, pricing request and we are trying and settle things and sometimes your credit for future business, but there is nothing unusual.

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**David J. Tamberrino** - *Goldman Sachs Group Inc., Research Division - Associate Analyst*

Okay, can you help us or help remind us what your annual steel buy is and how much of that you're exposed to that is in indexed or through one of your OEM customers?

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**Vincent Joseph Galifi** - *Magna International Inc. - Executive VP & CFO*

Yes, but 75% of our steel purchase is on customer resale 70%, 75%. The balance is going to be under some short term sort of fixed contract, some of it's at spot. So there really isn't a big impact on our results when steel moves around, because we do have a whole bunch of it on resale. The impact we sometime see is what happens to scrap revenue and some of that shares with our customers. The bigger impact on commodity cost volatility for us is actually resin pricing. And what we've been seeing over the years, David, is that our customers are moving more and more to resale programs on resin and we're still about 20%, 25% only resale on resin, so there is a long way to go. But resin is going to have the bigger impact from a volatility standpoint on earnings as opposed to steel.

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**Donald James Walker** - *Magna International Inc. - CEO & Director*

And David, I'll follow-up with you on the annual buy, I haven't got it at my fingertips right now.

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**David J. Tamberrino** - *Goldman Sachs Group Inc., Research Division - Associate Analyst*

And then just lastly from us. So the new business with NIO, we've seen one EV manufacturer struggle to get into mass volumes, what is the trajectory for that business, is it tens of thousands of units, is it hundreds of thousands of units? And how do you view this program versus other EV manufacturers?

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**Donald James Walker** - *Magna International Inc. - CEO & Director*

It's not high volume, David, it's more in the tens of thousands and in the hundreds of thousands, but...

**David J. Tamberrino** - *Goldman Sachs Group Inc., Research Division - Associate Analyst*

I mean, is it possible for you to just elaborate a little bit more, how you found working with this EV startup and the manufacturing processes that they have in place and the confidence level in kind of getting that ramped together?

**Donald James Walker** - *Magna International Inc. - CEO & Director*

Yes, I don't know the details on it. So I really can't comment. I think there's a lot of new people coming up with a new vehicle concepts, we're always -- I think it's more indicative as to whether we have the technology that our -- the customers like and it's costs competitive and technically good. So it's more of an indication of our capability rather than seeing there could be a huge volume here, quite often some of these low-volume programs are good ones to test out new technologies as well on some. We're always pretty cautious about new startups, whether they will hit the volumes, whether they're going to succeed financially, and I think the level of electrification, the powertrain is certainly increasing. I'm still -- we're still cautious about how fast pure EVs will sell in the markets as I said earlier.

**Operator**

Thank you. We have no further questions at this time. I'll turn the call back over to our speakers for -- to continue the presentation or for any closing remarks.

**Donald James Walker** - *Magna International Inc. - CEO & Director*

Okay. Well, I appreciate everybody calling in today. I think we had a really solid 2017 with a lot going on in the industry, there's a lot of opportunity, a lot of challenge this year and some new technologies in the ADAS and powertrain. But overall pretty pleased with the progress we're making. So thanks everybody, and have a great day.

**Operator**

Thank you, ladies and gentlemen. That does conclude the conference call for today. We thank you for your participation. And ask that you please disconnect your lines. Thank you. And have a good day.

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