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MG.TO - Q3 2016 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 Incorporated third-quarter 2016 results conference call. During the presentation, all participants will be in a listen-only mode. Afterwards, we will conduct a question-answer session.

(Operator Instructions)

As a reminder, this conference is being recorded, Thursday, November 3, 2016. I would like to turn the conference over to Louis Tonelli, Vice President of Investor Relations.

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

Thank you. Hello, everybody, and welcome to our third-quarter 2016 conference call. Joining me today are Don Walker, Chief Executive Officer; and Vince Galifi, Chief Financial Officer.

Earlier today, our Board of Directors met and approved our financial results for third quarter ended September 30, 2016. We issued a press release this morning for the quarter. You will 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 www.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 differ 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 we review financial information today, please note that operating results for the interiors operations that we sold in 2015 are presented as discontinued operations, and this review of results will address continuing operations only. Please also note that all figures discussed today are in US dollars, unless otherwise noted.



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In the appendix to our slide package accompanying the call today, we include a reconciliation of certain key financial statement lines between reported results and results excluding unusual items. There are no unusual items reported in the third quarter of 2016.

In the third quarter of 2015, we reported a gain on the disposition of a portion of our Bestop business, and reported net restructuring charges related to our European exteriors business. The net of these increased operating income by \$124 million, net income attributable to Magna by \$68 million and DPS by \$0.16. Our quarterly earnings discussion today excludes the impact of these unusual items.

Now, I will pass the call over to Don.

Don Walker - Magna International Inc. - CEO

Thanks, Louis. Hello, everyone. Some of the quarter highlights we will cover today include our continued strong organic growth, our record Q3 results, and Vince will take you through the quarter details; a return of \$288 million to shareholders in the form of share repurchases and buybacks; our recent acquisition of BOCO, which strengthens our closures business; and Magna started celebration last month of the successful run, producing the MINI Countryman and Paceman.

Magna star is already preparing for new program launches over the next couple of years that are expected to significantly increase assembly sales. We have been highlighting the consistency of performance of our sales growth relative to light vehicle production. Our strong growth continued in the third quarter of 2016.

In the quarter, total sales grew 16% over the third quarter of 2015. Our organic sales growth, excluding net acquisitions and adjustment for movements in foreign exchange rates, was 9% in the quarter, this compares to about 3% growth for global light vehicle production. Our global organic sales outperformance relative to the market was 6% in the third quarter.

Similarly, North American production sales grew 10% organically, excluding acquisitions in foreign exchange movements, this compares to about 1% growth for North American light vehicle production, which represents 9% outperformance compared to the market. European production sales grew 11% organically, compared to a decline of 2% for the European light vehicle production, this represents 13% outperformance compared to the market. And Asian production sales grew 44% organically, excluding acquisitions and foreign exchange movements compared to 8% for Asian production, this represents a full 36% outperformance, more than 5 times the growth in the Asian market.

In addition to our strong sales performance, we posted third-quarter records in EBITDA and adjusted EBIT, net income from continuing operations and earnings per share from continuing operations. Part of what is driving organic growth is our success in bringing innovations to our customers.

Accelerating innovation remains one of our top priorities and a key element to Magna strategy. We have highlighted a number of our technologies recently, for example, our Trailer Reverse Guidance System, a vision-based ADAS product, it's featured on the 2017 Ford Super Duty pickup truck.

The all-new Alfa Romeo Giulia all-wheel-drive sport sedan is powered by our transfer case and front axle drive. And our innovative recliners and seat tracks are enabling our EZ Entry at second row vehicle seats that are equipped on a newly-launched vehicle, and that has grown interest from other customers.

We also recently announced that we had celebrated the production of our 500,000th liftgate for the Nissan Rogue, launched in October of 2013. It is the North American industry's first all-thermoplastic, fully-recyclable plastic liftgate module. Magna has since been awarded business from other customers for this liftgate technology and we have additional interest from others OEMs.

Many of our innovations have also gained industry recognition. We received top honors from the Society of Plastic Engineers, both in North America and in Europe. These awards covered a number of our products, including our active grille shutter, which improves vehicle aerodynamics, as well as our carbon fiber hood for the Cadillac ATSb and CTSb. The hood weighs roughly 27% less than the aluminum version, and is the first of its kind in mass production.



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On the M&A front, we recently announced we have agreed to acquire BOCO as supplier of latches, hinges, and strikers. With one facility in Germany and one facility in China, BOCO complements Magna's closures manufacturing and engineering capabilities and it strengthens our technology leadership position in the global closure systems market.

Lastly, we announced this past quarter that we will be assembling the BMW 5 Series, beginning in 2017. Our MINI assembly business ended production in early October, having produced over 606,000 Countryman and Paceman models for markets worldwide. Magna Steyr is now busy preparing for the launch of the 5 Series, as well as the launch of programs for JLR, which will begin in the second half of 2017. Our garage assembly facility is expected to reach approximately 200,000 units per year by 2018, compared to about 76,000 units this year.

With that, I will pass the call over to Vince.

Vince Galifi - *Magna International Inc. - EVP and CFO*

Thank you, Don, and good morning, everyone. I would like to review our financial results for the third quarter ended September 30, 2016.

In the third quarter, our consolidated sales increased 16% or \$1.2 billion, relative to the third quarter of 2015 to a third-quarter record of \$8.8 billion. Reported North American production sales increased 13% in the third quarter to \$4.8 billion, a third-quarter record, while North American vehicle production increased 1%, to 4.3 million units. The North American production sales increase is a result of the launch of new programs and the acquisition of Getrag, partially offset by lower production volumes in certain programs, the de-consolidation of Bestop, and [net] customer price concessions.

Reported European production sales increased 29% from the comparable quarter to \$2.2 billion, a third-quarter record. While European vehicle production declined 2% with 4.7 million units. This increase was primarily the result of net acquisitions and the launch of new programs. These were partially offset by the weakening of the British pound against the US dollar, lower production volumes in certain existing programs, and net customer price concessions.

Asian production sales increased 58% or \$202 million from the comparable quarter to \$548 million, this is an all-time quarterly record. This was primarily as a result of the launch of new programs, primarily in China, and acquisitions. These were partially offset by the weakening of the Chinese RMB against the US dollar and net customer price concessions.

Rest of world production sales increased 7% or \$8 million to \$119 million for the third quarter, primarily as a result of the launch of new programs, [substantially] in Brazil, and new customer price increases, subsequent to the third quarter of 2015. These were partially offset by lower production volumes in certain existing programs, and the net weakening of South American currencies against the US dollar.

Complete diesel assembly volumes declined 19% from the comparable quarter, while assembly sales declined 4% to \$503 million. The decline in assembly volumes on the MINI Countryman and Paceman, as these programs near the end of production, and the end of production for the Peugeot RCZ during the third quarter of 2015 were partially offset by higher volumes on the Mercedes-Benz G-Class.

In summary, consolidated sales, excluding tooling, engineering and other sales increased approximately 18% or \$1.2 billion in the third quarter. Tooling, engineering, and other sales decreased 7% or \$47 million from the comparable quarter to \$658 million.

The adjusted EBIT margin in the quarter increased to 8.1% from 7.4% in the third quarter of 2015. The adjusted EBIT margin was positively impacted by productivity and efficiency improvements to certain facilities, a lower proportion of tooling and other sales to total sales, lower commodity costs, a lower proportion of complete vehicle assembly sales, and lower (inaudible) costs. These factors were partially offset by operational inefficiencies at certain facilities, including one body and chassis operation in North America, higher warranty costs, the acquisition of Getrag, a higher amount of employee profit sharing, higher severance costs, and [mold] recoveries associated with scrap steel.

Interest expense increased \$14 million to \$23 million in the third quarter of 2016, largely related to the increase in debt associated with the purchase of Getrag. In the third quarter of 2016 our effective tax rate was 25.7%, compared to 27.9% in Q3 of 2015. This largely reflects a decrease in



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nondeductible foreign-exchange adjustments related to the re-measurement of financial statement balances at certain foreign subsidiaries, an increase in R&D credits in North America and an increase in equity income. These were partially offset by a change in our reserve for uncertain tax positions.

Diluted EPS from continuing operations was \$1.29, a Q3 record, compared to \$0.97 in the third quarter of 2015. The increase in diluted earnings per share was a result of higher net income from continuing operations in a lower-weighted average number of diluted shares outstanding for the quarter, primarily due to the repurchase and cancellation of common shares, pursuant to our normal course issuer bids.

Let me review our cash flows and investment activities now. During the third quarter of 2016, we generated \$796 million cash from operations prior to changes in operating assets and liabilities, and invested \$139 million in operating assets and liabilities. For the quarter, investment activities amounted to \$556 million, including \$390 million in fixed assets, and \$166 million increase in investments and other assets.

The increase in investments and other assets includes an \$84 million loan to one of our equity-accounted joint ventures. In the third quarter, we also invested \$180 million in short-term restricted cash deposits. These deposits were security for EUR165 million drawn on a euro credit facility that includes a netting arrangement with the bank that provides a legal right of setoff.

We also repurchased 4.7 million common shares for \$191 million, and paid \$97 million in dividends in the quarter. Year to date, we have repurchased 19.8 million shares for \$799 million.

Our border proofs have to get approval by the Toronto and New York stock exchanges, a new normal course issuer bid to purchase up to 38 million of our common shares. This new bid would expire in November 2017. Our balance sheet remains strong with \$364 million in cash, as of September 30, 2016, and an additional \$2.1 billion in unused credit available to us.

I am going to now cover our revised outlook. We have lowered our light vehicle production assumption in North America by 200,000 units. This reflects a shortfall from expectations in Q3 production, as well as expected lower production in Q4, relative to our previous expectations.

We have increased volumes approximately 100,000 units in Europe for 2016. This increase relates to an adjustment to previously-reported vehicle production in the first half of 2016. Note, that our reported light vehicle production includes some estimates that are updated as actual volumes are reported. In short, our expectations for European production in the second half of 2016 are essentially unchanged from our previous outlook.

Our total sales range for 2015 has been held and is largely unchanged at the mid-point. Our outlook is \$35.8 billion to \$37 billion. Our North American production sales range was reduced from our previous outlook, reflecting the lower light vehicle production expectations and an expected lower Canadian dollar.

Our European production sales range was narrow, and erased from our previous outlook, reflecting improved program mix and a stronger average euro in the second half of 2016. Our Asian production sales range was narrow, but largely unchanged and rest of the world was tweaked up very slightly compared to our previous outlook.

Our complete vehicle assembly sales range was narrow, but is essentially unchanged from our previous outlook. Implicit in our total sales outlook is an approximately \$200 million increase in tooling, engineering and other sales, on which we earned low or no margin.

Our adjusted EBIT margin outlook for 2016 remains at approximately 8%. Our income tax rate and interest expense on those ranges are both unchanged from our previous outlook. Our capital spending range has been reduced slightly to the range of \$1.8 billion to \$1.9 billion for 2016.

Lastly, with respect to segment EBIT expectations, we moved the range up in Asia to 8% to 9% from the 7.5% to 8% range in our last outlook. This reflects better than previously anticipated performance.

In summary, we continue to significantly up our vehicle production in the third quarter. We've posted our third Q3 records this past quarter, and our most recent outlook is in line with our previous outlook.



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This concludes our formal remarks. Thanks for your attention today. We will be pleased to answer your questions at this time.

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

[Etienne Kelly], Citigroup.

Etienne Kelly - Citigroup - Analyst

Good morning, everybody. Just maybe a first question on kind of thinking about the margin in the fourth quarter. I think that typically sequentially do get a little bit of a bump up in the margin Q4 versus Q3. Just curious, I know with some of the production adjustments in North America, how are you thinking about the fourth quarter versus typical seasonal patterns?

Don Walker - Magna International Inc. - CEO

Good morning. I think when you look at overall Q4 this quarter, I guess I am looking at sort of expectations in Q3 versus expectations now. I think there has been a couple of moving pieces that may impact reported Q4 margins.

The first is the drop in North American sales, and part of that is production, part of it is a little bit of exchange. And an increase in European sales. When you think about the margin profile to North America and Europe, by having a bigger proportion in Europe, that is going to have a negative impact on overall reported margin.

The other thing to keep in mind is that we are expecting higher tooling, engineering and other sales over previous expectations that is going to fall into Q4. That increase in sales, you don't really have a lot of pull through on the bottom line on that. On a reported basis, that has a negative impact to margin.

I think the other sort of change from our prior expectation to now relates to my formal comments on one operation in North America, that's the launch of a substantial program in the third quarter, we have incurred some launch costs more than what we had expected, and we expect that is going to continue to impact us negatively in Q4. When you put that altogether, there are a lot of moving pieces, and a lot of good things going on in the Company. We are very comfortable holding our margin guidance intact at the approximately 8% for the year.

Etienne Kelly - Citigroup - Analyst

That is very helpful. Let me get a followup beyond 2016, I know it is early to talk about details for 2017.

I think a few suppliers have talked about a flattish global auto production environment next year. Just curious to kind of your latest thoughts on (inaudible) your investor day, both on the overall market growth globally as well as Magna's outgrowth relative to the market, if you could update us on that, that would be helpful.



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Don Walker - *Magna International Inc. - CEO*

Sure can. (Inaudible) [IHS] have been lowering their estimate of production for some of the other years and we kind of look at our overall business plan for 2017 and beyond. Our expectations are a little more muted than what they would have been eight or nine months ago, in terms of production growth in the major markets that we operate.

But having said that, we are still thinking that production is going to be flatter up in our most important markets, continue to grow in China. We'll land on an exact number by the time we get to January.

In terms of our prospects on overall sales, again, we are in the middle of business plan time, but at this point I don't see any reason why we should be changing kind of overall -- I'll have to think about volumes and what that does to overall sales, but we are pretty comfortable and the business that we talked about back in investor day, and we continue to make progress on booking new programs, which has certainly helped to firm up sales, especially in the outer years.

Etienne Kelly - *Citigroup - Analyst*

That is very helpful, thanks so much.

Operator

Ryan Brinkman, JPMorgan.

Samik Chatterjee - *JPMorgan - Analyst*

Hello. Good morning.

This is Samik on behalf of Ryan. Just following up on [Eti's] question there, I am not looking to get any guidance on 2017 yet, but in relation to volume leverage you have from growth in production and revenues next year. Can you help us with where there would be other drivers for margin expansion that we should keep in mind going into 2017?

Don Walker - *Magna International Inc. - CEO*

I think when you start thinking of it, I am not going to get into 2017 or numbers at this point in time. I think some the things that are going to help us drive margin is going to be Getrag. We talked about Getrag in the middle of a number of launches in Europe and in Asia, and as those more along, I don't remember exactly the cascade of that, but that should help us continue to grow margins in Europe and in Asia.

When you think about Getrag and the impact in North America, Getrag business is going to wind down in North America, I think it's completed at some point in 2018, but I'm not sure that's going to have a significant impact at all in North America. We continue to focus on overall improving efficiencies in Europe. We can go back over a number of years, we have a plan in place to move up margins, I think we have been very successful in doing that.

We are still focusing on continuing to improve those margins, as some of those unprofitable programs, if we still have some, unwind and new business starts to ramp up, that should be positive. I think we got also take into account the impact that Magna Steyr may have, and again, I don't have Magna Steyr's numbers for 2017, but Magna Steyr is also going to be in our rampup in 2017, so to the extent that sales are on a relative basis are smaller in 2017 versus 2016, that could have some sort of impact on reported margins.

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Samik Chatterjee - JPMorgan - Analyst

Got it. To stay on margins here, just a quick followup, and maybe I missed it, was there inefficiency at the plant level in North America, the three plants that we have been watching for a while, was there any sort of drag on the North America margins from this plants?

Vince Galifi - Magna International Inc. - EVP and CFO

In my formal comments, when I talked about the puts and takes in overall margins, I talked a bit, one of the negatives in the quarter on a year-over-year basis was one of those under-performing operations. We were in the middle of a pretty significant launch in Q3, and we incurred costs that were higher than what we were anticipating. I think that will spill into Q4. And is going to reflect overall forecast.

With respect to the other ones, as we've talked about on the call last quarter, we are on track, we're seeing improvement, we continued to be on track to see improvement. As far as we are concerned, we kind of want to not deal with all of these under-performing plants. I think we need we've got a good plan in place to move forward.

Samik Chatterjee - JPMorgan - Analyst

Got it. And just a final question, if I may.

You talked in the comments you mentioned about the growth outlook for 2017 having moderate effect compared to what it was a few months or a year ago. Are you seeing any change in the customer price concessions that you are being asked for in relation to production outlook moderating?

Don Walker - Magna International Inc. - CEO

No. I think that the pricing -- the price reduction requests are happening all the time, they continue to happen. I think it is good news that a lot of our customers are healthy and they have got good financial results so they can take a long-term view of total cost of a product, rather than doing the short-term actions that may be not wise, but they would be forced if they weren't doing well.

We really haven't seen any difference and everybody wants price reductions. I doubt things will change, we don't expect any huge downturn, but I think for the most part the suppliers that are around today have a pretty good idea of what their costs are and what they can get back, and most of them are trying to engineer it out through product design or continuous improvement, but there is really no change.

Samik Chatterjee - JPMorgan - Analyst

Great. Thank you.

Don Walker - Magna International Inc. - CEO

Operator is there another question? Operator?

Operator

Mr. Murphy, your line is open, please proceed.

John Murphy - BofA Merrill Lynch - Analyst

Hello, guys, can you hear me?



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Don Walker - Magna International Inc. - CEO

Yes, we can.

John Murphy - BofA Merrill Lynch - Analyst

I apologize. I got on the call late, but just on Steyr, as we think about the drag that you are seeing as production is winding down there on the outgoing products and then the ramp back up of the 5 Series. Just curious, how we should think about the cadence of that drag, and then that relaunch or ramp in production, Vince, as we think about next year?

Vince Galifi - Magna International Inc. - EVP and CFO

John, you probably didn't hear Don's formal comments, but what Don talked about is the MINI Countryman and Paceman ended the production in the first or second week in October. That is behind us. As you look at Q4, certainly Magna Steyr's sales are going to be impacted as a result of that.

And in terms of the 5 Series, it is ramping up in the first half of 2017, I am not sure exactly when that is, I don't have it handy with me, but it'll start to ramp up. We will see obviously, if you look at a year-over-year basis, sales being negatively impacted at Magna Steyr until we start to ramp up this program.

John Murphy - BofA Merrill Lynch - Analyst

Okay. And it should be added as we get through the second half of 2017 on a year-over-year basis, then, I would assume.

Vince Galifi - Magna International Inc. - EVP and CFO

John. Let's get through our business plan. I just want to kind of look at all the volumes and the rampup, and we'll give you certainly some color in January.

John Murphy - BofA Merrill Lynch - Analyst

Okay. And then just a second question on cap allocation. Obviously you guys have reauthorized your share buyback.

There is a lot of different theories that are flying around right now, as far as cap allocation, as far as conserving cash or some of your peers making acquisitions that are leveraging up. I am just curious as you are thinking about cap allocation events, is this a period where you might pull back your horns on share buybacks and look at other opportunities or preserve cash? There's a lot of different strategies and changes that are going on here.

Vince Galifi - Magna International Inc. - EVP and CFO

That is a really good question, John. I think we debated it a lot at the Board, in terms of authorizing (inaudible). Our overall strategy has not changed. It has been consistent for a very long time.

We do generate a tremendous amount of cash each and every year. What we like to do with that cash is invest in business for the right opportunity, whether that is organic or through M&A, and we have got a very disciplined approach for M&A strategy.

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We look at things that hit our overall product strategy which align us better for car of the future, which advance our technological capability. We're at the end of the quarter, our adjusted debt to adjusted EBITDA was about 1.26 times, kind of in the mid range of 1 to 1.5 times. As I think about 2017 and capital allocation, we are going to invest the business and capital is still going to be a pretty significant number in 2017.

We're going to pay dividends and as net income goes up, we probably shouldn't surprised if the dividend increases in Q4. Based on essentially opportunities we see on the M&A side, we'll look at buybacks and M&A or a combination of the two. We are sitting in a 1.25 times leverage ratio. We have a tremendous amount of flexibility on the balance sheet, even if we're doing buybacks, if right opportunity comes along to pull the trigger.

John Murphy - BofA Merrill Lynch - Analyst

Okay. That is helpful. And just lastly, there is also been some divergence in where schedules are going with some of your big customers in North America pulling back on production and some adding.

I am just curious what you are seeing in releases in the 30, 60-day timeframe, and if there has been any major shifts or the announcements are made and they largely stick to them. I am just trying to gauge the volatility in production schedules in the near term.

Don Walker - Magna International Inc. - CEO

Not a lot of change. We have seen declines.

Q3 was less than we'd anticipated, Q4 we brought our production down reflecting some of those production cuts. Nothing really volatile in our releases at this point, but it is something that obviously the divisions will monitor on a regular basis.

John Murphy - BofA Merrill Lynch - Analyst

Great. Thank you very much.

Operator

David Tyerman, Cormark Securities.

David Tyerman - Cormark Securities - Analyst

Yes. Good morning, gentlemen. The first question is just on the North American plant that is having the issues. Are the issues large enough that they are actually moving the margin in a meaningful way in North America?

Vince Galifi - Magna International Inc. - EVP and CFO

They are negative impacts over our margin. I am not sure I would characterize it in a meaningful way. When you look at overall margins in North America, you have still have some pretty healthy margins in Q3. We are at 10% for the quarter.

David Tyerman - Cormark Securities - Analyst

Right.



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Don Walker - Magna International Inc. - CEO

But it is [everybody's] impacting. You can look at a quarter, there's a whole bunch of things that go in and out. How you look at warranty cost, you look at commodity cost, you look at incremental sales and all of that. But it is negatively impacting recovery for the margin in North America.

David Tyerman - Cormark Securities - Analyst

I guess another way of asking is if you get this plant up to normal operations, and I would think you would want to, would the margins, say, next year be different in North America? Like, would they be a half point higher or something because of this, or is it really not in that kind of magnitude?

Don Walker - Magna International Inc. - CEO

Not that sort of magnitude, David. Certainly it would be accretive to everything else being identical to what it was in Q3 would be accretive, but again, you need to understand launch paths. All the normal things we look at.

David Tyerman - Cormark Securities - Analyst

Right.

Don Walker - Magna International Inc. - CEO

Everything would be equal [to margins].

David Tyerman - Cormark Securities - Analyst

Right. And just on the Q4, you mentioned a bunch of factors that are going to affect the margins in Q4 production European sales being up higher tooling, et cetera. Everything you mentioned sounded like they were drags. Is there anything that is going to help in Q4, since you have kept the guidance for the year?

Vince Galifi - Magna International Inc. - EVP and CFO

Sure, I think that we have raised our guidance in Asia from a margin perspective. I think you have got to picture it, we have got a number of operating divisions, so we have highlighted some things. We talk about approximately 8%, that does not mean it is 8.000%. It could be approximately, there is a little bit of a range there. So, we are comfortable where we were in Q3, and where we expect to be in Q4 or something, we'll see that we're still in that target range.

Don Walker - Magna International Inc. - CEO

Vince was talking about the back half old forecasts or versus the new outlook. Some of that comes to in the third quarter and the Asian pull-through was pretty strong in the quarter as well, so that's a positive for the full-year change in outlook.

David Tyerman - Cormark Securities - Analyst

Okay. That is helpful. Just on the launch profile at Steyr, you talked about the 5 Series. The two JLR programs, what's the launch profile on those?



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Don Walker - Magna International Inc. - CEO

I think they will have a pretty insignificant impact, David, in 2017. I think you're looking more in 2018.

Vince Galifi - Magna International Inc. - EVP and CFO

It launches late in 2017.

David Tyerman - Cormark Securities - Analyst

Okay. And last question, the warranty was quite a lot higher in the quarter. Is there any particular reason or is this just a normal volatility we see?

Vince Galifi - Magna International Inc. - EVP and CFO

There is a warranty item, a particularly larger claim in one of our groups that dates back to a high-volume program, a previous-generation program that hit us in the quarter. But other than that, it just, you know, when you find out about something and when you book it. Other than for that one larger type item.

David Tyerman - Cormark Securities - Analyst

Good enough. Thank you very much.

Don Walker - Magna International Inc. - CEO

Yes.

Operator

Peter Sklar, BMO Capital Markets.

Peter Sklar - BMO Capital Markets - Analyst

This insurance recovery that you mentioned in Europe, there was a net insurance recovery. Vince, can you give us an idea of what the magnitude was in terms of financial impact?

Vince Galifi - Magna International Inc. - EVP and CFO

Sure, Peter, I can. I think when I sit back and look at the overall quarter, there is always pluses and minuses. David had just asked about warranty.

Warranty was sort of a year-over-year, a \$20 million additional cost. We had some other things that are pluses and minuses, pretty well net to zero.

The insurance proceeds that we -- net insurance proceeds that we bought was less than the increase in the warranty costs in the quarter, so less than \$20 million. But I think we put the warranty, and the fire insurance recovery and everything else pretty well nets to zero.



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Peter Sklar - *BMO Capital Markets - Analyst*

Okay. Got it. Also you mentioned higher severance costs during the quarter. I am just wondering what that relates to, were there some restructuring activities being undertaken somewhere?

Don Walker - *Magna International Inc. - CEO*

No, Peter, you know what? It is just ones and twosies in a number of places, it is normal course. I think when you look at it to the prior period, it was something a little higher. Nothing from an unusual perspective during the normal course of business.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay. And then just lastly, back to China. As you know, the Chinese, I guess it is a sales tax or exemption ends at the end of December. I am just wondering what you are hearing in terms of the government is going to have some programs to replace that or do you anticipate that there will be some slowdown because of the pull-forward effect of that tax exemption?

Vince Galifi - *Magna International Inc. - EVP and CFO*

Peter, our point of view is that there is going to be probably some form of continuation of a tax incentive into 2017, and it will probably be less than where it is today. We expect there will be something.

Having said that, our view is also that there is some pull forward of demand into 2016, which will probably negatively impact 2017. In terms of the magnitude of that, we will just have to wait and see when we get through Q4, and whether there is further clarity on the tax incentives and when that clarity is put in place.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay. Thank you.

Operator

Michael Glenn, Macquarie Securities.

Michael Glenn - *Macquarie Securities - Analyst*

Hello, thanks for taking the question. Just in terms of your assembly, there has been quite a bit of press recently about you guys potentially expanding assembly. Can you just speak to how we should think about that, where you might look to do that, and what kind of capital outlay you might see there at the structure of a deal and the return on capital we should expect to see from that?

Vince Galifi - *Magna International Inc. - EVP and CFO*

Michael, we have been asked a lot about whether we like our complete vehicle assembly operation and the [insurance] associated with that. It is a good business for us. It allows us early visibility of OEM strategy.

We are working it from an engineering perspective, I think it helps not only Magna Steyr, but the rest of our companies. We have been asked if there is an opportunity we could put up more capital, and the argument has always been, we like the business, if there was a right opportunity or



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opportunities, we'd consider putting more capital in place to support the business. How much that could be, where it could be, will depend on the size of the opportunity or where the opportunity or opportunities lie.

Don Walker - *Magna International Inc. - CEO*

If we get to the point where we book something, we would obviously announce it, but we are already at capacity in the out years. We are at capacity in garages in Austria. One of the things we are looking at is how do we get some additional capacity if we could take on extra programs? We are looking at our options there.

Michael Glenn - *Macquarie Securities - Analyst*

Okay. And can you comment at all on what kind of, if you were to do something along those lines, what sort of return on capital profile you would look for on that investment?

Vince Galifi - *Magna International Inc. - EVP and CFO*

More than applies to capital. It would have to meet our hurdle rates. Again, depending on where our plant would be, what the profile of the contracts or contract would be, we've set our hurdle rate based on that.

Michael Glenn - *Macquarie Securities - Analyst*

Okay. Just in terms of the iris product, you have put out a couple press releases on that. Can you just speak to your growth expectations on that product in particular, maybe some of the conversations you are having with customers. Is there a lot of interest getting developed there?

Don Walker - *Magna International Inc. - CEO*

There is certainly a lot of development and new technologies coming into the market when you are talking about a autonomous driving vehicles, and that can be in a lot of different areas. In our electronics business, we've got, we're very big in cameras and also the software and converting the image you get into something useful in a vehicle.

We can give updated guidance in January, when we talk about the overall business and how we are progressing. We are still on track from what we talked about at our last investor meeting in our ADAS products. I still think that the entrance of fully-autonomous vehicles into the market anywhere is quite a ways out, but the penetration of vision-based technologies for assisted driving continues pretty well in line for what we thought it would be.

Michael Glenn - *Macquarie Securities - Analyst*

Okay. I will leave it there. Thanks.

Operator

(Operator Instructions)

Rich Kwas, Wells Fargo Securities.



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Rich Kwas - Wells Fargo Securities, LLC - Analyst

Hello, good morning, everyone. As we think of Getrag, as we think out longer term, I am just looking back at your presentation back in January and there is a ramp in revenues expected in 2018 and 2019.

Either Vince or Don, could you just comment on how we should think about the leverage coming off of those revenues, revenue growth in 2018 and 2019? Is that going to, more or less, mimic traditional Magna, or is there anything that we should think about in terms of incremental margins and how Getrag would differ potentially or be in line with traditional Magna.

Don Walker - Magna International Inc. - CEO

Generically, if we look at the powertrain product area, it is pretty high capitals, and we always look at, we don't look at margins, we're looking at what's the return on invested capital. So, you would expect that margins in high-capital products would give us higher margins. That is the only way you can get to those hurdle rates and in -- the return of invested capital.

I don't remember off the top of my head, but the sales growth are in consolidated sales, because part of it is still joint ventures and part of it is wholly-owned. But we are seeing significant sales growth in Getrag. When we bought the business we looked at what we thought would be the sales growth and the margin growth in the execution of the product in the launches, and right now, it is performing well.

Vince Galifi - Magna International Inc. - EVP and CFO

Rich, you also have got to keep in mind, when you think about the Getrag organization, it is an essential part of the business is equity accounted, and all the growth that is going to take place, in particular in China. Equity accounting gets reported as equity income. That will increase -- as long as we're making money, then we expect to make money will increase reported margins, because we don't have any sales but we have come.

So, you've got to keep that in mind. As we look at the business from a management perspective, and we are looking at the managed business, we ignore kind of equity income and look at sales and profitability and returns on the capital that's imported in the business.

Rich Kwas - Wells Fargo Securities, LLC - Analyst

Okay. That is helpful. And when we think about 2017, is it going to be pretty similar in terms of, I think the expectation was going to be pretty neutral this year for 2016.

So, we think about similarly along those lines for 2017 before the ramp up in 2018? Is that a reasonable way to think about things right now?

Vince Galifi - Magna International Inc. - EVP and CFO

We are just running through business plans and Getrag will be the first ones running through our process. I don't have today an update on 2017 and 2018. But if I go back to our initial presentation, we were expecting that Getrag would be accretive in 2017.

As you said earlier, kind of flat to -- neutral to maybe a little bit positive in 2016. I can tell you, based on year-to-date performance in Getrag that they are performing better than expected. That is helpful from an earnings-per-share standpoint in 2016.

We will give you some more color as we come up with our business plan. We will talk about that in January.



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Rich Kwas - Wells Fargo Securities, LLC - Analyst

Okay. Two quick ones. Just to clarify on the Magna Steyr. In terms of the programs that have been announced that you've won that are going to launch, does that get you, does that absorb your existing capacity?

And then if you want additional programs then you would have to think about adding? I just wanted to clarify some the comments from earlier.

Vince Galifi - Magna International Inc. - EVP and CFO

Rich, I think when you look at the BMW and the JLR programs that we have announced, that gets us pretty close to, depending on what year you're are looking at, pretty close to capacity. I think these guys are pretty creative at Magna Steyr, and there is probably some room to squeeze in a small program in there.

We are pretty close to capacity. If the right opportunity comes along and if a more substantial program, as we talked about earlier in the call, it would require an investment in a new facility.

Rich Kwas - Wells Fargo Securities, LLC - Analyst

Okay. And just last one on steel. Was that a good guy here for the quarter? I think, Vince, you talked about it being a potential headwind in 2017, I realize you're still going through the process. Was it helpful so far, and should we think of it more in terms of a headwind next year, at least big picture items?

Vince Galifi - Magna International Inc. - EVP and CFO

You know, when you look at overall commodity costs, on a year-over-year basis a little accretive, and that is coming from a think about the quarter, it is resin. I think overall scrap was a little negative on a year-over-year basis, but we are monitoring steel prices. Steel prices were moving up, we're pretty well protected from a resale perspective on steel.

But obviously, the steel strap impact is -- steel prices were moving up and more recently they have been coming off with it. I don't have a clear view on what is going to happen in 2017, but when we get close, again, closer to January, we give you a view on where we think commodity costs may be for 2017 compared to 2016.

Rich Kwas - Wells Fargo Securities, LLC - Analyst

Okay. Thank you.

Operator

David Tyerman, Cormark Securities.

David Tyerman - Cormark Securities - Analyst

A quick question for Don. Don, I think you've said in the past, and I think it is industry consensus, electric drive trends will be, maybe even hybrids, fairly small part of the market for quite a long time, maybe even through the middle of next decade.

I have been reading quite a few articles recently quoting people from places like Daimler saying that things are progressing pretty fast, includes in terms of densities and costs. I'm wondering if you have any changed view on that at this point?



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Don Walker - *Magna International Inc. - CEO*

I don't think we are going to see the penetration of pure electric vehicles to be substantial in the next foreseeable future, in the next foreseeable future out to 2025. Whether do they get from the 3%, 6%? I have seen numbers out there that are substantially higher than that, I just don't see it happening, based on the battery technology out there.

I do think that, for a number of reasons, what happened with the diesel gate, what is happening with legislation and technology, I do think that you are going to see a faster penetration of hybrids. And there is various implications, but if you look at a hybrid, actually from a Getrag standpoint it's good, because it got some interesting technology that lends itself to hybrids.

We are actually working on a paper which we haven't gotten done yet, I am trying to get the input from the OEMs on what do we think, what's the consensus on the penetration of electric vehicles, what is the penetration on full autonomous driving vehicles or what time period, ride sharing, things like that. Specifically to your answer, ED is not a huge change, although General Motors has just come out with a new fully electric vehicle, it will be interesting to see how it is received by consumers. I do think hybrids will continue to penetrate.

David Tyerman - *Cormark Securities - Analyst*

Thank you. I look forward to your paper.

Operator

Mark Neville, Scotia Capital.

Mark Neville - *Scotiabank - Analyst*

Hello, good morning. Just in North America, you brought production numbers down a little bit, some of your customers are talking about bringing production in Q4 down. I am just curious on year end. Is there anything that you guys have done at this point to maybe protect margins a bit, for lack of better word I guess, whether it's in-sourcing work or whatever it is or is it still too early to make some of these changes?

Don Walker - *Magna International Inc. - CEO*

Every one of our divisions would have to look at what their particular products are, who their customers are, and make decisions on what actions they will take once they see it. I haven't seen a lot that would indicate we -- production is going down. We just came from a big supplier conference from General Motors and they are still pretty bullish on what they are doing from their market share and their production.

However, depending on what the product is, we will typically outsource some of our production. If there is lower margins, we can in-source, we will be looking at carrying some temporary label people, but it really is specific plant by plant.

We will have to wait and see what happens, I think. In many cases, we are seeing the exact opposite, where we are seeing customers pull over their recorded volumes, and we are running hard the staff up with it.

Mark Neville - *Scotiabank - Analyst*

Okay. That helps. Just on Getrag. You mentioned integration, I think it was performing a bit better than expected. Is it integration type stuff?



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I am just curious longer term. It has been over a year now. Sort of have your views on the business changed at all sort of incrementally, more positives or more negatives, or just how you feel about it after almost a year?

Don Walker - *Magna International Inc. - CEO*

Overall, I am pleased. They were having some operational issues when we took them over and they have done a good job in getting over those. The launches seem to be going well.

I haven't heard of any major issues. They brought the DCT not 300 to market in many different areas. So, there's always (indiscernible), specific things we have to work with, but overall, it seems to be going well.

Their product, I think, is well aligned with what we see the market requiring in the future, and I think a lot of people are focused on fuel efficiency and the DCTs are good in that area, on hybrids they have got some really impressive technology in those areas. We are looking at what their strategy is for electrification and what we are doing in power trains. We think there are some good opportunities there.

There will be a lot of changing technologies. The operational improvements really haven't come from synergies at this point in time, because we're still working on that.

We can in-source with they can in-source. Where we can leverage purchasing, so we're seeing it in some of these synergies, but I think that will be more in the out years.

Mark Neville - *Scotiabank - Analyst*

Okay. Thanks a lot.

Operator

Mr. Walker, we are showing no further questions at this time. I will turn the conference back over to you.

Don Walker - *Magna International Inc. - CEO*

Okay. Thanks, everybody for dialing in. It was a good quarter. We still have got some opportunities ahead of us, but overall, things are going well. I guess the next time we will be seeing many of you will be in the Detroit show in January. We will have gone through our business plans, and we will be giving you an update on our outlook. Thanks, everybody, for your time.

Operator

Thank you. This does conclude the conference. We thank you for your participation and ask that you please disconnect your lines.



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