

***Nemak, S. A. B. de C. V. and subsidiaries***

(subsidiary of Alfa, S. A. B. de C. V.)

Consolidated Financial Statements

December 31, 2016 and 2015

# ***Nemak, S. A. B. de C. V. and subsidiaries***

(subsidiary of Alfa, S. A. B. de C. V.)

Index

December 31, 2016 and 2015

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## **Report of independent auditors**

Monterrey, N.L., February 17, 2017

To the Shareholders and Directors of  
Nemak, S. A. B. de C. V. and subsidiaries

### **Opinion**

We have audited the consolidated financial statements of Nemak, S. A. B. de C. V. and subsidiaries (the "Company"), which comprise the consolidated statements of financial position as of December 31, 2016 and 2015 and the related consolidated statements of income, of comprehensive income, of changes in stockholders' equity and of cash flows for the years then ended, and the explanatory notes to the consolidated financial statements, which include a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as at December 31, 2016 and 2015, and its financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board ("IFRS").

### **Basis for Opinion**

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the "Auditor's Responsibilities for the Audit of the Consolidated Financial Statements" section of our report. We are independent of the Company in accordance with the Ethics Standards of Mexican Institute of Public Accountants, A.C. together with other requirements applicable to our audits of consolidated financial statements in Mexico, and we have fulfilled our other ethical responsibilities in accordance with those requirements and standards. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### **Key Audit Matters**

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

## Key audit matter

## How our audit addressed the key audit matter

### Goodwill impairment assessment

As described in Note 3.k.a), the Note 5.1.a) and Note 12 to the consolidated financial statements, the Company performs annual impairment assessment on the goodwill balance.

We have focused on this matter due to the importance of the balance thereof at December 31, 2016 totals Ps5,837 million and because the impairment testing involves applying significant management judgments in determining: i) the company's cash generating units ("CGU") and ii) the assumptions and premises related to assessment of the recovery value of said CGUs.

In particular, we focused on the following significant assumptions that the Company considered when assessed the goodwill: estimation of future projections, growth rates, gross margins and discount rates used.

As part of our audit, we assessed future cash flows projections prepared by Management and the processes used to prepare them. In particular, we assessed whether all relevant CGUs were identified and the internal processes were carried out by Management to make projections, including timely oversight and analysis by those charged with Governance, and if the projections are consistent with budgets approved by them.

Due to the significant judgments used in the valuation models for the determination of recovery values, and with the support of our valuation experts, we questioned the premises and criteria used by Management in such models, following procedures set down below:

- We verified that the methods applied to the determination of the recovery values of the assets correspond to used and recognized methodologies to value assets of similar characteristics.
- We challenged the financial projections, including terminal value, matching them to the performance and historical trends of the Company, obtaining Management's explanations variations.
- We compared actual results for the current year with the figures budgeted for prior year, to determine whether any of the assumptions included in the projections could be considered very optimistic.
- We compared the most relevant valuation assumptions (applied discount rate, betas, EBITDA multiples, sale multiples, among others) against those commonly used and accepted for assets of these characteristics for the industry in which the Company operates.

We discussed with Management the sensitivity calculations for all CGUs and evaluated the extent to which the assumptions would need to be modified for impairment to be required. Moreover, we discussed with Management the probability of those changes being made.

	<p>With a mi respect to the significant judgment to group CGUs, we analyzed and considered the following aspects:</p> <ul style="list-style-type: none"> <li>• Understanding of the workings of the commercial and sales strategy area</li> <li>• Understanding the production allocation</li> <li>• Analysis of the operating cash flows and indebtedness policies</li> <li>• Analysis of the legal structure.</li> </ul>
<p>Evaluation of the estimation and recoverability of the deferred income tax asset</p> <p>As described in Note 3.m), Note 5.1.b) and Note 16 to the consolidated financial statements, the Company recorded a deferred tax asset arising from tax losses and therefore Management performed a recoverability assessment thereof prior to recognizing it in its financial statements.</p> <p>We have focused on this line item in our audit due to the importance of the balance of the deferred tax asset arising from tax losses at December 31, 2016 (Ps1,538 million) and because the estimate of its recoverable value involves the application of significant judgments to determine expected future income, future projections, as well as tax results by the Company's Management.</p> <p>In particular, we focused our audit efforts on the items mentioned in the previous key matter.</p>	<p>As part of our audit, we evaluated the projections used to determine the recovery of deferred income tax asset of tax losses. We compared these projections with those used to determine the recoverable value of the aforementioned goodwill, over which we apply procedures similar to those indicated above.</p> <p>With the support of experts, we also evaluated and considered the projected tax results prepared by Management, as well as the processes used to elaborate them by applying the above procedures to them. We also challenge, with the support of our tax experts, the assumptions used by Management in the tax projections.</p> <p>We compared the actual results of the current year with the budgeted figures of the previous year for the current year, to consider whether any assumptions included in the projections could be considered very optimistic.</p> <p>Likewise, as discussed above, we discussed sensitivity calculations with Management and assessed the extent to which assumptions would need to be modified to require an adjustment.</p>

## Other Information

Management is responsible for the other information presented. The other information comprises the Annual Report presented to Comisión Nacional Bancaria y de Valores ("CNBV") and the Annual Information presented to shareholders (but does not include the consolidated financial statements and our auditor's report thereon), which are expected to be made available to us after the date of this auditor's report. Our opinion on the consolidated financial statements does not cover the other information and we will not express any form of assurance conclusion thereon.

However, in connection with our audit of the financial statements of the Company, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

When we read the other information not yet received, we will issue the report required by the CNBV and if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance and, if required, describe the issue in our report.

### **Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements**

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS and for such internal control as Management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, Management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless Management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

### **Auditors' Responsibilities for the Audit of the Consolidated Financial Statements**

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by Management.
- Conclude on the appropriateness of Management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company and subsidiaries to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Company and subsidiaries audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Ricardo Noriega Navarro.

PricewaterhouseCoopers, S.C.



C.P.C. Ricardo Noriega Navarro  
Audit Partner

***Nemak, S. A. B. de C. V. and subsidiaries***  
(subsidiary of Alfa, S. A. B. de C. V.)  
Consolidated Statements of Financial Position  
At December 31, 2016 and 2015

Millions of Mexican pesos

		December 31,	
<u>Assets</u>	<u>Note</u>	<u>2016</u>	<u>2015</u>
Current Assets:			
Cash and cash equivalents	6	Ps 2,661	Ps 1,793
Restricted cash	7	474	323
Trade and other receivables, net	8	11,581	10,720
Inventories	9	11,784	9,667
Available for sale assets		40	-
Advanced payments		<u>367</u>	<u>277</u>
<b>Total current assets</b>		<u>26,907</u>	<u>22,780</u>
Non-current Assets:			
Property, plant and equipment	11	50,094	38,263
Goodwill and intangible assets, net	12	12,057	9,216
Deferred income tax	16	1,520	1,321
Other non-current receivables	8, 26	720	-
Other non-current assets	13	<u>595</u>	<u>439</u>
<b>Total non-current assets</b>		<u>64,986</u>	<u>49,238</u>
<b>Total assets</b>		<u>Ps 91,893</u>	<u>Ps 72,018</u>
<u>Liabilities and Equity</u>			
<u>Liabilities</u>			
Current Liabilities:			
Current debt	15	Ps 3,699	Ps 952
Trade and other payables	14	18,894	16,515
Current income tax liabilities		549	311
Other liabilities	17	<u>542</u>	<u>993</u>
<b>Total current liabilities</b>		<u>23,684</u>	<u>18,771</u>
Non-current Liabilities:			
Non-current debt	15	25,310	21,758
Employee benefits	18	1,058	779
Deferred income tax	16	4,152	2,765
Other non-current liabilities	17	<u>618</u>	<u>6</u>
<b>Total non-current liabilities</b>		<u>31,138</u>	<u>25,308</u>
<b>Total liabilities</b>		<u>54,822</u>	<u>44,079</u>
<u>Equity</u>			
Controlling Interest:			
Capital stock	19	6,607	6,607
Share premium	19	10,434	10,443
Retained earnings	19	12,309	8,645
Other reserves	19	<u>7,721</u>	<u>2,244</u>
<b>Total equity</b>		<u>37,071</u>	<u>27,939</u>
<b>Total liabilities and equity</b>		<u>Ps 91,893</u>	<u>Ps 72,018</u>

The accompanying notes are an integral part of these consolidated financial statements.



Armando Tamez Martínez  
Chief Executive Officer



Alberto Sada Medina  
Chief Financial Officer

***Nemak, S. A. B. de C. V. and subsidiaries***  
(subsidiary of Alfa, S. A. B. de C. V.)  
Consolidated Statements of Income  
For the years ended December 31, 2016 and 2015

*Millions of Mexican pesos*

	<u>Note</u>	<u>2016</u>	<u>2015</u>
Revenue		Ps 79,244	Ps 70,891
Cost of sales	21	<u>(65,345)</u>	<u>(59,143)</u>
Gross profit		13,899	11,748
Administrative and selling expenses	21	(4,957)	(4,393)
Other (expenses), revenues net	22	<u>(258)</u>	<u>43</u>
Operating profit		8,684	7,398
Financial income	23	14,657	6,245
Financial expense	23	<u>(16,096)</u>	<u>(7,538)</u>
Financial result, net		<u>(1,439)</u>	<u>(1,293)</u>
Share of gain of associates	13	<u>55</u>	<u>48</u>
Profit before income tax		7,300	6,153
Income tax	25	<u>(1,890)</u>	<u>(1,552)</u>
Net consolidated profit		<u>Ps 5,410</u>	<u>Ps 4,601</u>
Profit attributable to:			
Controlling interest		Ps 5,410	Ps 4,599
Non-controlling interest	3 b)	<u>-</u>	<u>2</u>
		<u>Ps 5,410</u>	<u>Ps 4,601</u>
Earnings per basic and diluted share, in pesos		<u>Ps 1.76</u>	<u>Ps 1.65</u>
Weighted average of outstanding shares (millions)	19	3,081	2,781

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Armando Tamez Martínez  
Chief Executive Officer



Alberto Sada Medina  
Chief Financial Officer

**Nemak, S. A. B. de C. V. and subsidiaries**

(subsidiary of Alfa, S. A. B. de C. V.)

**Consolidated Statements of Comprehensive Income****For the years ended December 31, 2016 and 2015***Millions of Mexican pesos*

	<u>Note</u>	<u>2016</u>	<u>2015</u>
Net consolidated profit		<u>Ps 5,410</u>	<u>Ps4,601</u>
Other comprehensive income for the year, net of tax:			
Items that will not be reclassified to profit or loss:			
Remeasurement of obligations for employee benefits	18	(55)	(10)
Items that will be reclassified to profit or loss:			
Effect of derivative financial instruments designated as cash flow hedges	10	46	(248)
Effect of translation of foreign entities	19	<u>5,486</u>	<u>1,390</u>
Total other comprehensive income for the year		<u>5,477</u>	<u>1,132</u>
Total comprehensive income for the year		<u>Ps10,887</u>	<u>Ps5,733</u>
Attributable to:			
Controlling interest		Ps10,887	Ps5,732
Non-controlling interest	3 b)	<u>-</u>	<u>1</u>
Total comprehensive income for the year		<u>Ps10,887</u>	<u>Ps5,733</u>

The accompanying notes are an integral part of these consolidated financial statements.


Armando Tamez Martínez  
Chief Executive OfficerAlberto Sada Medina  
Chief Financial Officer


**Nemak, S. A. B. de C. V. and subsidiaries**  
(subsidiary of Alfa, S. A. B. de C. V.)  
**Consolidated Statements of Changes in Equity**  
**For the years ended December 31, 2016 and 2015**

Millions of Mexican pesos

	Note	Capital stock	Share premium	Retained earnings	Other reserves	Total controlling interest	Non-controlling interest	Total equity
		Ps	Ps	Ps	Ps	Ps	Ps	Ps
Balances at January 1, 2015		874	-	19,505	1,101	21,480	-	21,498
Transactions with shareholders:								
Dividends declared	19	-	-	(1,253)	-	(1,253)	-	(1,253)
Increase of capital stock	19	14,196	-	(14,196)	-	-	-	-
Merger with GIALFA	19	55	-	-	-	55	-	55
Capital distribution	19	(9,544)	-	-	-	(9,544)	-	(9,544)
Initial public offering	19	1,026	10,443	-	-	11,469	-	11,469
	19	5,733	10,443	(15,449)	-	727	-	727
Acquisition of non-controlling interest	3b	-	-	-	-	-	(19)	(19)
Net profit		-	-	4,599	-	4,599	2	4,601
Other items of comprehensive income for the year		-	-	(10)	1,143	1,133	(1)	1,132
Total comprehensive income for the year		-	-	4,589	1,143	5,732	1	5,733
Balances at December 31, 2015		6,607	10,443	8,645	2,244	27,939	-	27,939
Transactions with shareholders:								
Dividends declared	19	-	-	(1,755)	-	(1,755)	-	(1,755)
Initial public offering		-	(9)	9	-	-	-	-
		-	(9)	(1,746)	-	(1,755)	-	(1,755)
Net profit		-	-	5,410	-	5,410	-	5,410
Other items of comprehensive income for the year		-	-	-	5,477	5,477	-	5,477
Total comprehensive income for the year		-	-	5,410	5,477	10,887	-	10,887
Balances at December 31, 2016		6,607	10,434	12,309	7,721	37,071	-	37,071

The accompanying notes are an integral part of these consolidated financial statements.

  
Armando Tamez Martínez  
Chief Executive Officer

  
Alberto Sada Medina  
Chief Financial Officer

***Nemak, S. A. B. de C. V. and subsidiaries***  
(subsidiary of Alfa, S. A. B. de C. V.)  
**Consolidated Statements of Cash Flows**  
**For the years ended December 31, 2016 and 2015**

*Millions of Mexican pesos*

	<u>Note</u>	<u>2016</u>	<u>2015</u>
<b>Cash flows from operating activities</b>			
Profit before income tax		Ps 7,300	Ps 6,153
Depreciation and amortization	11, 12	5,872	4,609
Costs associated with seniority premiums and pension plan		97	57
Loss on sale of property, plant and equipment	22	4	12
Impairment of property, plant and equipment		293	-
Effect of changes in the fair value of derivative financial		0	617
Exchange gain (loss), net		230	(452)
Interest paid		1,117	1,105
Other, net		(28)	(59)
Increase in trade and other receivables		1,229	(2,193)
Increase in inventory		(548)	(748)
Increase in accounts payable		(1,361)	2,687
Income tax paid		<u>(1,380)</u>	<u>(1,563)</u>
Net cash generated from operating activities		<u>12,825</u>	<u>10,225</u>
<b>Cash flows from investing activities</b>			
Interest received		11	15
Acquisition of property, plant and equipment	11	(6,896)	(6,265)
Acquisition of intangible assets	12	(1,972)	(988)
Dividends received		21	-
Restricted cash		(1)	(22)
Business acquisition, net of cash received	2a	(56)	-
Other assets		<u>29</u>	<u>22</u>
Net cash used in investing activities		<u>(8,864)</u>	<u>(7,238)</u>
<b>Cash flows from financing activities</b>			
Proceeds from borrowings or debt	15	10,994	20,907
Payments of borrowings or debt	15	(11,960)	(21,075)
Interest paid		(1,112)	(1,115)
Derivative financial instruments paid	10	-	(1,743)
Capital stock contributed, net of issuance costs of Ps428 in 2015	19	(9)	11,469
Capital distribution	19	-	(9,544)
Acquisition of non-controlling interest	3b	-	(2)
Dividends paid		<u>(1,755)</u>	<u>(1,253)</u>
Cash used in financing activities		<u>(3,842)</u>	<u>(2,356)</u>
Increase in cash and cash equivalents		119	631
Foreign exchange in cash and cash equivalents		749	185
Cash and cash equivalents at beginning of year	6	<u>1,793</u>	<u>977</u>
Cash and cash equivalents at end of year	6	<u>Ps 2,661</u>	<u>Ps 1,793</u>
Transactions not requiring cash flow:			

In 2016, the main transaction no requiring cash flow corresponds to the debt assumed in the acquisition of a business, as explained in Note 2a.

In 2015, the main transaction no requiring cash flow corresponds to capitalization of the restatement of capital stock and retained earnings. See Notes 2b and 2c.

The accompanying notes are an integral part of these consolidated financial statements.



Armando Tamez Martínez  
Chief Executive Officer



Alberto Sada Medina  
Chief Financial Officer

# ***Nemak, S. A. B. de C. V. and subsidiaries***

(subsidiary of Alfa, S. A. B. de C. V.)

Notes to the Consolidated Financial Statements

At December 31, 2016 and 2015

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*Millions of Mexican pesos*

## **Note 1 - General information:**

Nemak, S. A. B. de C. V. and subsidiaries (“Nemak” or “the Company”), subsidiary of Alfa, S. A. B. de C. V. (“ALFA”), is a company that specializes in the production of complex aluminum components for the automotive industry, such as cylinder heads, engine blocks, transmission parts, structural parts and other components. Nemak’s principal executive offices are located at Libramiento Arco Vial Km. 3.8, Col. Centro in García, Nuevo León, México.

References made to the holding company Nemak, S. A. B. de C. V. as an individual legal entity will be referred to as “Nemak SAB”.

Nemak SAB is a public corporation and its shares are traded on the Mexican Stock Exchange, S. A. B. de C. V. (“BMV” for its acronym in Spanish). The Company is 75.24% owned by Alfa, S. A. B. de C. V., 5.45% owned by Ford Motor Company and the remaining by a group of Mexican and foreign investors through the BMV. Alfa has the power to control the Company's affairs and policies.

In the following notes to the financial statements pesos or “Ps” refers to Millions of Mexican pesos. On the other hand, “US\$” or dollars, refers to millions of US dollars. Information in millions of euros are referred as “EUR” or Euros.

Certain figures included in this financial statements and its notes have been rounded for ease of presentation. Also, certain other amounts that appear in this financial statements and its notes may not sum due to rounding.

## **Note 2 - Significant Events:**

### 2016

#### **a. Acquisition of Cevher Döküm**

On November 1, 2016, Nemak acquired the total shares of CEVHER DÖKÜM SANAYİİ A.Ş (“Cevher”), a company engaged in the production of cast aluminum parts for the manufacture of automobile components. The acquired entity operates a production plant in Turkey and a small trading entity. This acquisition is included as part of the Europe segment (See Note 27).

At December 31, 2016, the Company is in the process of concluding the purchase price allocation at the fair values of the assets acquired, due to the fact that it is reviewing the valuation conducted by independent experts. Said analysis is expected to conclude within a twelve-month period, as from the acquisition date.

## ***Nemak, S. A. B. de C. V. and subsidiaries***

(subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

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The opening balances of the business acquired are as follows:

<u>Item</u>	<u>Carrying value</u>
Current assets	Ps 366
Property, plant and equipment	1,287
Intangible assets and other non-current assets	26
Current liabilities	(747)
Debt	(603)
Deferred tax	(80)
Other non-current liabilities	<u>(192)</u>
Carrying value of the business acquired	56
Purchase consideration	<u>56</u>
Goodwill	<u>Ps -</u>

The purchase consideration for the business totaled Ps56 (EUR 2.5) in cash.

No contingent liability has arisen from this acquisition that would require posting. Moreover, there are no contingent compensation agreements in place. Nemak is not liable for the environmental liabilities, except for those arising on or after the acquisition date.

Costs related to the acquisition amounted Ps15 and were recorded in the statement of income, in the other expenses, net caption.

Additionally, the entity changed its business name to Nemak Izmir Döküm Sanayii, A. S.

Revenue contributed by former Cevher assets included in the consolidated statement of income since the acquisition date through December 31, 2016 amounted to Ps182 and a net loss of Ps36.

#### 2015

##### **b. Capital stock increase and change of legal name**

On May 27, 2015 in a General Extraordinary Shareholders' meeting was approved:

- Modify the shares structure by the conversion of our Series B, Series A-1 and Series B-1 shares into Series A common shares of capital stock, with no par value.
- Remove the par value of one Mexican peso of each share, issuing new shares without par value and replacing the outstanding shares at this date.
- Increase the Capital stock from Ps874 to Ps15,070 through the capitalization of retained earnings. See note 19.
- Change in the legal name from Tenedora Nemak, S. A. de C. V. to Nemak, S. A. de C. V.

## ***Nemak, S. A. B. de C. V. and subsidiaries***

(subsidiary of Alfa, S. A. B. de C. V.)

Notes to the Consolidated Financial Statements

At December 31, 2016 and 2015

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### **c. Merger with GIALFA**

On May 28, 2015, the Company held a general extraordinary shareholders' meeting at which they approved the merger by absorption with its affiliate Grupo Gialfa, S. A. de C. V. (Gialfa) subsisting Nemak, S. A. de C. V. (formerly Tenedora Nemak, S. A. de C. V.). Since Gialfa and Nemak, S. A. de C. V. are controlled by ALFA, the merger was accounted as a transaction between companies under common control, therefore, the net assets of Gialfa were accounted by Nemak, S. A. de C. V. at book value according to the historical consolidated financial information of ALFA (cost based in the predecessor accounting method), resulting in an increase in capital stock of Ps55 and the acquisition of tax attributes of Gialfa. As a result, the book value of the net assets merged into Nemak, S. A. de C. V. is equal to that ALFA had in its consolidated financial statements and no goodwill or fair value adjustments were recognized. See Note 19.

### **d. Capital distribution**

On June 5, 2015, Nemak, S. A. de C. V. held a general extraordinary shareholders' meeting at which they approved the decrease of capital stock by a distribution to the shareholders in Ps10,838 without affecting the proportion of shares that each shareholder owns, resulting in an increase in accounts payable to shareholders by the same amount. In accordance with the current tax laws, the decrease generated no income tax (ISR).

On November 20, 2015, the Nemak SAB held a general extraordinary shareholders' meeting at which was agreed to amend the resolution of the shareholders meeting of June 5, 2015 to adjust the Capital distribution amount from the previously agreed value to the actual amount distributed to the shareholders of Ps9,544, and canceling the difference payable to the shareholders at the date of the amendment. See Note 19.

### **e. Initial Public Offering**

During the month of July, 2015, Nemak, S. A. de C. V. carried out an initial public offering of shares ("IPO") in Mexico and a private offering of shares in international markets (together "Global Offering") as follows:

- On June 15, 2015, Nemak, S. A. de C. V. had an Ordinary and Extraordinary General shareholders meeting in which was approved amongst other corporate activities the following: the issuance of the capital stock, a change in the legal regime to Sociedad Anónima Bursátil de Capital Variable, the latter, was subject to the placement of the new shares, a change to the bylaws, the appointment of the new board of directors, the establishment of the audit and corporate practices committee, appointment of committee members, amongst others.
- On July 1, 2015 Nemak SAB, carried out the Global Offering which corresponded to the issuance of 537,600,000 shares at an offer price of 20.00 pesos, such offering included an overallotment option of up to an additional 80,640,000 shares. The total amount of the offer was Ps10,752.
- On July 29, 2015, following up on the Global Offering, the underwriters, both in Mexico and abroad, agreed to exercise the overallotment option. The total amount of the greenshoe reached to Ps1,145 which corresponded to 57,232,845 shares at the offering price of 20.00 pesos each.

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Based on the above, the total amount the Company received as a result of the Global Offering was Ps11,469, net of the issuance costs of Ps428. Subsequent to the Global Offering the fully subscribed and paid capital stock of Nemak, is represented by a total of 3,080,747,324 Series A shares. See Note 19.

#### **f. Payment of Peso Bond**

In December 2015, the Company prepaid the total of the Peso Bond “Nemak -07” of Ps3,500. See Note 15. Consistent with this prepayment, the “Cross Currency Swap” derivatives which had been linked to this bond, was early terminated in its entirety. See Note 10 d.

#### **g. Contracted debt**

During December 2015, the Company obtained two new loans, the first being a five year term in the amount of US\$300 (Ps5,162) which was used to prepay the total amount of the Peso Bond “Nemak -07” of Ps3,500; the second was a 10 year term in the amount of US\$200 (Ps3,441) used to pay substantially all of the Company’s short term debt. See Note 15.

#### **h. Construction of two new plants in México**

During 2015, the Company started the construction of two production units in the same location where are the plants near Monterrey, México. The first of these units will increase the current capacity for machining services for pieces produced by the Company. The second plant will be dedicated to produce pieces by using the technology “High Pressure Die Casting”, which is already used in other plants of the Company. It is noteworthy that the new structural components which Nemak will produce soon, will be produced with this technology. The Company will start operation of its new plants in 2017, with a total investment of approximately US\$287 (Ps4,900). At December 31, 2016 and 2015 the Company has disbursed Ps1,070 and Ps1,686, respectively, related to the construction of this plants, recorded as construction in progress.

### **Note 3 - Summary of significant accounting policies:**

The accompanying consolidated financial statements and notes were authorized for issuance on February 17, 2017 by officials with the legal power to sign the basic financial statements and accompanying notes.

The following are the most significant accounting policies followed by Nemak and its subsidiaries, which have been consistently applied in the preparation of the financial information in the years presented, unless otherwise specified:

#### **a. Basis for preparation**

The consolidated financial statements of Nemak have been prepared in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). IFRS include all International Accounting Standards (“IAS”) in force and all related interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC), including those previously issued by the Standing Interpretations Committee (SIC).

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The consolidated financial statements have been prepared on a historical cost basis, except for the cash flow hedges which are measured at fair value, and for the financial assets and liabilities at fair value through profit or loss with changes reflected in the statement of income and for financial assets available for sale.

The preparation of the consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates. Additionally, it requires management to exercise judgment in the process of applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where judgments and estimates are significant to the consolidated financial statements, are disclosed in Note 5.

Nemak's consolidated financial statements are presented in millions of Mexican Pesos.

### **b. Consolidation**

#### **i. Subsidiaries**

The subsidiaries are all the entities over which the Company has the power to govern the financial and operating policies of the entity. The Company controls an entity when it is exposed, or has the right to variable returns from its interest in the entity and it is capable of affecting the returns through its power over the entity. Where the Company's participation in subsidiaries is less than 100%, the share attributed to outside shareholders is reflected recorded as non-controlling interest.

Subsidiaries are consolidated in full from the date on which control is transferred to the Company and up to the date it loses that control.

The method of accounting used by the Company for business combinations is the acquisition method. The Company defines any business combination as a transaction through which it acquires control of a business, based on which it has the power to manage the activities relevant to the group of assets and liabilities of such business in order to provide a return in the form of dividends, less costs or other economic benefits directly related to investors.

The consideration transferred for the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred and the equity interests issued by the Company. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Identifiable acquired assets and liabilities and contingent liabilities assumed in a business combination are initially measured at their fair values at the acquisition date. The Company recognizes any non-controlling interest in the acquiree based on the share of the non-controlling interest in the net identifiable assets of the acquired entity.

The acquisition-related costs are recognized as expenses when incurred.

Goodwill is initially measured as the excess of the sum of the consideration transferred and the fair value of the non-controlling interest over the net identifiable assets and liabilities assumed. If the consideration transferred is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognized directly in the consolidated statement of income.

The Company uses the business combination accounting by applying the method of the predecessor in an entity under common control. The predecessor method consists in the incorporation of values in books of the acquired entity, which includes the goodwill recorded at a consolidated level with respect to the acquired entity. Any difference between the consideration paid by the Company and the value in books of net acquired assets at the subsidiary level are recorded in equity.

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Transactions and intercompany balances and unrealized gains on transactions between Nemak companies are eliminated in preparing the consolidated financial statements. In order to ensure consistency with the policies adopted by the Company, the accounting policies of subsidiaries have been changed where it was deemed necessary.

At December 31, 2016, the subsidiaries that are included in the consolidated financial statements of Nemak were as follows:

	<u>Country</u> <sup>(1)</sup>	<u>Ownership percentage (%)</u> <sup>(2)</sup>	<u>Functional currency</u>
Nemak, S. A. B. de C. V. (Holding)	Mexico		US dollar
Nemak México, S. A.	Mexico	100	US dollar
Modellbau Schönheide GmbH	Germany	100	Euro
Corporativo Nemak, S. A. de C. V. (administrative services)	Mexico	100	Mexican peso
Nemak Canadá, S. A. de C. V. (sub-holding)	Mexico	100	Mexican peso
Nemak of Canada Corporation	Canada	100	Canadian dollar
Nemak Gas, S. A. de C. V.	Mexico	100	Mexican peso
Nemak Automotive, S. A. de C. V.	México	100	Mexican peso
Camen International Trading, Inc.	USA	100	US dollar
Nemak Europe GmbH	Germany	100	Euro
Nemak Exterior, S. L. (sub-holding)	Spain	100	Euro
Nemak Dillingen GmbH	Germany	100	Euro
Nemak Dillingen Casting GmbH & Co KG	Germany	100	Euro
Nemak Wernigerode GmbH	Germany	100	Euro
Nemak Wernigerode GmbH & Co. KG	Germany	100	Euro
Nemak Linz GmbH	Austria	100	Euro
Nemak Győr Kft	Hungary	100	Euro
Nemak Poland Sp. z.o.o.	Poland	100	Euro
Nemak Slovakia, S. r. o.	Slovakia	100	Euro
Nemak Czech Republic, S.r.o.	Czech Republic	100	Euro
Nemak Spain, S. L.	Spain	100	Euro
Nemak Rus, L.L.C.	Russia	100	Russian ruble
Nemak Pilsting, GmbH	Germany	100	Euro
Nemak Alumínio do Brasil Ltda.	Brazil	100	Brazilian real
Nemak Argentina, S. R. L.	Argentina	100	Argentine peso
Nemak Nanjing Aluminum Foundry Co., Ltd.	China	100	Renminbi yuan
Nemak Chongqing Automotive Components, Co, Ltd.	China	100	Renminbi yuan
Nemak Aluminum Casting India Private, Ltd	India	100	Indian rupee
Nemre Insurance, PTE LTD	Singapore	100	US dollar
Nemak Commercial Services, Inc.	USA	100	US dollar
Nemak USA, Inc.	USA	100	US dollar
Nemak Automotive Castings, Inc.	USA	100	US dollar
J. L. French Servicios, S. de R. L. de C. V.	Mexico	100	Mexican peso
J. L. French, S. de R. L. de C. V.	Mexico	100	Mexican peso
Nemak Izmir Döküm Sanavii A Ş. (3)	Turkey	100	Euro
Nemak Izmir Dis Ticaret A. Ş. (3)	Turkey	100	Euro

<sup>(1)</sup> Country of company's incorporation.

<sup>(2)</sup> Direct and indirect ownership percentage of Nemak SAB. Share ownership percentages as of December 31, 2016 and 2015, except for the entities constituted in 2015 and Modellbau Schönheide GmbH who became 100% subsidiary of Nemak SAB during 2015.

<sup>(3)</sup> Business acquisition in 2016.

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At December 31, 2016 and 2015, there are no significant restrictions in subsidiaries over the capacity of the Company to access the use of assets and pay off liabilities.

#### **ii. Absorption (dilution) of control in subsidiaries**

The effect of absorption (dilution) of control in subsidiaries, i.e., an increase or decrease in the percentage of control, is recorded in equity, directly in retained earnings, in the period in which the transactions that cause such effects occur. The effect of absorption (dilution) of control is determined by comparing the book value of the investment before the event of dilution or absorption against the book value after the relevant event. In the case of loss of control the dilution effect is recognized in income.

#### **iii. Sale or disposal of subsidiaries**

When the Company ceases to have control any retained interest in the entity is re-measured at fair value, and the change in the carrying amount is recognized in the income statement. The fair value is the initial carrying value for the purposes of accounting for any subsequent retained interest in the associate, joint venture or financial asset. Any amount previously recognized in comprehensive income in respect of that entity is accounted for as if the Company had directly disposed of the related assets and liabilities. This implies that the amounts recognized in the comprehensive income are reclassified to income for the year.

#### **iv. Associates**

Associates are all entities over which the Company has significant influence but not control. Generally an investor must hold between 20% and 50% of the voting rights in an investee for it to be an associate. Investments in associates are accounted for using the equity method and are initially recognized at cost. The Company's investment in associates includes goodwill identified at acquisition, net of any accumulated impairment loss.

If the equity in an associate is reduced but significant influence is maintained, only a portion of the amounts recognized in the comprehensive income are reclassified to income for the year, where appropriate.

The Company's share of profits or losses of associates, post-acquisition, is recognized in the income statement and its share in the other comprehensive income of associates is recognized as other comprehensive income. The cumulative movements after acquisition are adjusted against the carrying amount of the investment. When the Company's share of losses in an associate equals or exceeds its equity in the associate, including unsecured receivables, the Company does not recognize further losses unless it has incurred obligations or made payments on behalf of the associate.

The Company assesses at each reporting date whether there is objective evidence that the investment in the associate is impaired. If so, the Company calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value and recognizes it in "share of profit/loss of associates recognized by the equity method" in the income statement.

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Unrealized gains on transactions between the Company and its associates are eliminated to the extent of the Company's equity in such gains. Unrealized losses are also eliminated unless the transaction provides evidence that the asset transferred is impaired. In order to ensure consistency with the policies adopted by the Company, the accounting policies of associates have been modified. When the Company ceases to have significant influence over an associate, any difference between the fair value of the remaining investment, including any consideration received from the partial disposal of the investment and the book value of the investment is recognized in the income statement.

### **c. Foreign currency translation**

#### **i. Functional and presentation currency**

The amounts included in the financial statements of each of the Company's subsidiaries and associates should be measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements are presented in millions of Mexican pesos, which is the Company's presentation currency.

#### **ii. Transactions and balances**

Transactions in foreign currencies are translated into the functional currency using the foreign exchange rates prevailing at the transaction date or valuation date when the amounts are re-measured. Gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies at the closing exchange rates are recognized as foreign exchange gain or loss in the income statement, except for those which are deferred in comprehensive income and qualify as cash flow hedges.

Changes in the fair value of securities or monetary financial assets denominated in foreign currency classified as available for sale are divided between fluctuations resulting from changes in the amortized cost of such securities and other changes in value. Subsequently, currency fluctuations are recognized in income and changes in the carrying amount arising from any other circumstances are recognized as part of comprehensive income.

Translation differences on non-monetary assets, such as investments classified as available for sale, are included in other comprehensive income.

The exchange differences of monetary assets classified as financial instruments at fair value with changes in income are recorded in the statement of income as part of the fair value gains or losses.

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#### iii. Consolidation of foreign subsidiaries

Incorporation of subsidiaries whose functional currency is different from their recording currency.

The financial statements of foreign subsidiaries, having a recording currency different from their functional currency were translated into the functional currency in accordance with the following procedure:

- a. The balances of monetary assets and liabilities denominated in the recording currency were translated at the closing exchange rates.
- b. To the historical balances of monetary assets and liabilities and shareholders' equity translated into the functional currency there were added the movements occurred during the period, which were translated at historical exchange rates. In the case of the movements of non-monetary items recognized at fair value, which occurred during the period, stated in the recording currency, these were translated using the historical exchange rates in effect on the date when the fair value was determined.
- c. The revenue, costs and expenses of the periods, expressed in the recording currency, were translated at the historical exchange rate of the date they were accrued and recognized in the income statement, except when they arose from non-monetary items, in which case the historical exchange rate of the non-monetary items were used.
- d. The differences in exchange arising in the translation from the recording currency to the functional currency were recognized as income or expense in the income statement in the period they arose.

Incorporation of subsidiaries whose functional currency is different from their presentation currency.

The results and financial position of all Nemak entities (none of which is in a hyperinflationary environment) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- a. Assets and liabilities for each balance sheet presented are translated at the closing exchange rate at the balance sheet date.
- b. The equity of each balance sheet presented is translated at historical rates.
- c. Income and expenses for each income statement are translated at average exchange rate (when the average exchange rate is not a reasonable approximation of the cumulative effect of the rates of the transaction, to the exchange rate at the date of the transaction is used); and

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d. All the resulting exchange differences are recognized in comprehensive income.

The goodwill and adjustments to fair value arising at the date of acquisition of a foreign operation so as to measure them at fair value, are recognized as assets and liabilities of the foreign entity and translated at the exchange rate at the closing date. Exchange differences arising are recognized in other comprehensive income.

Listed below are the principal exchange rates in the various translation processes:

Country	Functional currency	Local currency to Mexican pesos			
		Closing exchange rate at		Average exchange rate at	
		December 31,		December 31,	
		2016	2015	2016	2015
Canada	Canadian dollar	15.41	12.39	14.21	12.41
USA	US dollar	20.66	17.21	20.54	17.01
Brazil	Brazilian real	6.35	4.34	6.21	4.29
Argentina	Argentine peso	1.30	1.33	1.30	1.52
Czech Republic	Euro	21.80	18.70	21.80	18.09
Germany	Euro	21.80	18.70	21.80	18.09
Austria	Euro	21.80	18.70	21.80	18.09
Hungary	Euro	21.80	18.70	21.80	18.09
Poland	Euro	21.80	18.70	21.80	18.09
Slovakia	Euro	21.80	18.70	21.80	18.09
Spain	Euro	21.80	18.70	21.80	18.09
China	Renminbi yuan	2.98	2.65	2.98	2.62
India	Indian rupee	0.30	0.26	0.30	0.25
Russia	Russian ruble	0.34	0.24	0.33	0.24
Singapore	US dollar	20.66	17.21	20.54	17.01
Turkey	Euro	21.80	18.70	21.80	18.09

d. Cash and cash equivalents

Cash and cash equivalents include cash on hand, bank deposits available for operations and other short-term investments of high liquidity with original maturities of three months or less, all of which are subject to insignificant risk of changes in value. Bank overdrafts are presented as current liabilities within other liabilities.

e. Restricted cash

Cash and cash equivalents whose restrictions cause them not to comply with the definition of cash and cash equivalents given above, are presented in a separate line in the statement of financial position and are excluded from cash and cash equivalents in the statement cash flows.

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## **f. Financial instruments**

### **Financial assets**

The Company classifies its financial assets in the following categories: at fair value through profit or loss, loans and receivables, investments held to maturity and available for sale. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets upon initial recognition. Purchases and sales of financial assets are recognized on the settlement date.

Financial assets are written off in full when the right to receive the related cash flows expires or is transferred and the Company has also transferred substantially all risks and rewards of ownership, as well as control of the financial asset.

### **i. Financial assets at fair value through profit or loss**

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Derivatives are also categorized as held for trading unless they are designated as hedges.

Financial assets at fair value through profit or loss are initially recognized at fair value and transaction costs are expensed in the income statement. Gains or losses from changes in fair value of these assets are presented in the income statement as incurred.

### **ii. Loans and receivables**

The receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets.

Loans and receivables are measured initially at fair value plus directly attributable transaction costs and subsequently at amortized cost, using the effective interest method. When circumstances occur that indicate that the amounts receivable will not be collected at the amounts originally agreed or will be collected in a different period, the receivables are impaired.

### **iii. Maturity investments**

If the Company intends and has the demonstrable ability to hold debt securities to maturity, they are classified as held to maturity. Assets in this category are classified as current assets if expected to be settled within the next 12 months, otherwise they are classified as non-current. Initially they are recognized at fair value plus any directly attributable transaction costs, and subsequently they are valued at amortized cost using the effective interest method. Investments held to maturity are recognized or derecognized on the day they are transferred to or by the Company. At December 31, 2016 and 2015, the Company had no such investments.

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### **iv. Financial assets available for sale**

Financial assets available for sale are non-derivative financial assets that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless their maturity is less than 12 months or management intends to dispose of the investment within the next 12 months after the balance sheet date.

Financial assets available for sale are initially recognized at fair value plus directly attributable transaction costs. Subsequently, these assets are carried at fair value (unless they cannot be measured by their value in an active market and the value is not reliable, in which case they will be recognized at cost less impairment).

Gains or losses arising from changes in fair value of monetary and non-monetary instruments are recognized directly in the consolidated statement of comprehensive income in the period in which they occur.

When instruments classified as available for sale are sold or impaired, the accumulated fair value adjustments recognized in equity are included in the income statement.

### **Financial liabilities**

Financial liabilities that are not derivatives are initially recognized at fair value and are subsequently valued at amortized cost using the effective interest method. Liabilities in this category are classified as current liabilities if expected to be settled within the next 12 months, otherwise they are classified as non-current.

Trade payables are obligations to pay for goods or services that have been acquired or received from suppliers in the ordinary course of business. Loans are initially recognized at fair value, net of transaction costs incurred. Loans are subsequently carried at amortized cost; any difference between the funds received (net of transaction costs) and the settlement value is recognized in the income statement over the term of the loan using the effective interest method.

### **Offsetting financial assets and liabilities**

Assets and liabilities are offset and the net amount is presented in the balance sheet when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis or to realize the asset and settle the liability simultaneously.

### **Impairment of financial instruments**

#### **a. Financial assets carried at amortized cost**

The Company assesses at the end of each year whether there is objective evidence of impairment of each financial asset or group of financial assets. An impairment loss is recognized if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a "loss event") and provided that the loss event (or events) has an impact on the estimated future cash flows arising from the financial asset or group of financial assets that can be reliably estimated.

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Aspects evaluated by the Company to determine whether there is objective evidence of impairment are:

- Significant financial difficulty of the issuer or debtor.
- Breach of contract, such as late payments of interest or principal
- Granting a concession to the issuer or debtor, by the Company, as a result of financial difficulties of the issuer or debtor and that would not otherwise be considered.
- There is a likelihood that the issuer or debtor will enter bankruptcy or other financial reorganization.
- Disappearance of an active market for that financial asset due to financial difficulties.
- Verifiable information indicates that there is a measurable decrease in the estimated future cash flows related to a group of financial assets after initial recognition, although the decrease cannot yet be identified with the individual financial assets of the Company, including:
  - i. Adverse changes in the payment status of borrowers in the group of assets
  - ii. National or local conditions that correlate with breaches of noncompliance by the issuers of the asset group.

Based on the items listed above, the Company assesses whether there is objective evidence of impairment. Subsequently, for the category of loans and receivables, when impairment exists, the amount of loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the original effective interest rate. The carrying amount of the asset is reduced by that amount, which is recognized in the income statement.

If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. Alternatively, the Company could determine the impairment of the asset given its fair value determined on the basis of a current observable market price.

If in the subsequent years, the impairment loss decreases and the decrease can be related objectively to an event occurring after the date on which such impairment was recognized (such as an improvement in the debtor's credit rating), the reversal of the loss impairment is recognized in the income statement.

The calculation of the accounts receivable impairment is described in Note 8.

#### **b. Financial assets available for sale**

In the case of debt financial instruments, the Company also uses the above-listed criteria to identify whether there is objective evidence of impairment. In the case of equity financial instruments, a significant or prolonged reduction in its fair value below its cost is also considered objective evidence of impairment. At December 31, 2016 and 2015, the Company has no debt financial instruments classified as available for sale.

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Subsequently, in the case of financial assets available for sale, an impairment loss determined by computing the difference between the acquisition cost and the current fair value of the asset, less any impairment loss previously recognized, is reclassified from the other comprehensive income accounts and recorded in the income statement. Impairment losses recognized in the income statement related to equity financial instruments are not reversed through the income statement. Impairment losses recognized in the income statement related to financial debt instruments could be reversed in subsequent years, if the fair value of the asset is increased as a result of a subsequent event.

### **g. Derivative financial instruments and hedging activities**

All derivative financial instruments are identified and classified as fair value hedging hedges or cash flow hedges, for trading or the hedging of market risks and are recognized in the balance sheet as assets and/or liabilities at fair value and similarly measured subsequently at fair value. The fair value is determined based on recognized market prices. When there is no market quote, they are determined based on valuation techniques in the financial sphere.

The fair value of hedging derivatives is classified as a non-current asset or liability if the remaining maturity of the hedged item is more than 12 months and as a current asset or liability if the remaining maturity of the hedged item is less than 12 months.

Derivative financial instruments classified as hedges are contracted for risk hedging purposes and meet all hedging requirements; their designation at the beginning of the hedging operation is documented, describing the objective, primary position, risks to be hedged and the effectiveness of the hedging relationship, characteristics, accounting recognition and how the effectiveness is to be measured, applicable to this transaction.

During 2015, the Company decided to cancel the hedge accounting of its derivative financial instruments, as a result of which, at December 31, 2016 and 2015, the Company has no derivative financial instruments classified as fair value hedges, cash flow hedges or net investment hedges.

### **h. Inventories**

Inventories are stated at the lower of cost and net realizable value. Cost is determined using the average cost method. The cost of finished goods and work-in-progress includes cost of product design, raw materials, direct labor, other direct costs and production overheads (based on normal operating capacity). It excludes borrowing costs. The net realizable value is the estimated selling price in the normal course of business, less the applicable variable selling expenses. Costs of inventories include any gain or loss transferred from equity corresponding to raw material purchases that qualify as cash flow hedges

### **i. Property, plant and equipment**

Items of property, plant and equipment are recorded at cost less the accumulated depreciation and any accrued impairment losses. The costs include expenses directly attributable to the asset acquisition.

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be reliably measured. The carrying amount of the replaced part is derecognized. Repairs and maintenance are recognized in the income statement during the year they are incurred. Major improvements are depreciated over the remaining useful life of the related asset.

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Depreciation is calculated using the straight-line method, considering separately each of the asset's components, except for land, which is not subject to depreciation. The average useful lives of assets families are as follows:

Buildings and constructions	33 to 50 years
Machinery and equipment	10 to 14 years
Transportation equipment	4 to 8 years
Furniture and office equipment	6 to 10 years
Other fixed assets	10 to 20 years

The spare parts to be used after one year and attributable to specific machinery are classified as property, plant and equipment in other fixed assets.

General and specific borrowing costs related to the acquisition, construction or production of qualifying assets, which necessarily require a substantial period to be ready prior to their use or sale (9 months), are capitalized as part of the cost of acquiring such qualifying assets, up to the moment when they are suitable for their intended use or sale.

If the carrying value is greater than the estimated recovery value, a decrease in value is recorded in the value in books of an asset and it is immediately recorded at its recovery value.

Assets classified as property, plant and equipment are subject to impairment tests when events or circumstances occur indicating that there are signs of impairment. Impairment losses are recognized for the amount by which the carrying amount of the asset exceeds its recoverable amount.

The residual value, useful lives and depreciation method of assets are reviewed at least at the end of each reporting period and, if expectations differ from previous estimates, the changes are accounted for as a change in accounting estimate.

Gains and losses on disposal of assets are determined by comparing the sale value with the carrying amount and are recognized in other expenses, net, in the income statement.

#### **j. Leasing**

The classification of leases as finance or operating depends on the substance of the transaction rather than the form of the contract.

Leases in which a significant portion of the risks and rewards relating to the leased property are retained by the lessor are classified as operating leases. Payments made under operating leases (net of incentives received by the lessor) are recognized in the income statement based on the straight-line method over the lease period.

Leases where the Company assumes substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalized at the beginning of the lease, at the lower of the fair value of the leased property and the present value of the minimum lease payments. If its determination is practical, in order to discount the minimum lease payments to present value, the interest rate implicit in the lease is used; otherwise, the incremental borrowing rate of the lessee should be used. Any initial direct costs of the leases are added to the original amount recognized as an asset.

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Each lease payment is allocated between the liability and finance charges to achieve a constant rate on the outstanding balance. The corresponding rental obligations are included in non-current debt, net of finance charges. The interest element of the finance cost is charged to the income for the year during the period of the lease, so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. Property, plant and equipment acquired under finance leases are depreciated over the shorter of the asset's useful life and the lease term.

### **k. Intangible assets**

Intangible assets are recognized in the balance sheet when they meet the following conditions: they are identifiable, provide future economic benefits and the Company has control over such benefits.

Intangible assets are classified as follows:

- i. Indefinite useful life. - These intangible assets are not amortized and are subject to annual impairment assessment. At December 31, 2016 and 2015, no factors have been identified limiting the life of these intangible assets.
- ii. Finite useful life. - These assets are recognized at cost less accumulated amortization and impairment losses recognized. They are amortized on a straight line basis over their estimated useful life, determined based on the expectation of generating future economic benefits, and are subject to impairment tests when triggering events of impairment are identified.

The estimated useful lives of intangible assets with finite useful lives are summarized as follows:

Development costs	5 to 20 years
Customer relationships and others	5 to 17 years
Software and licenses	3 to 11 years
Trademarks and patents	15 to 20 years

### **a. Goodwill**

Goodwill represents the excess of the acquisition cost of a subsidiary over the Company's equity in the fair value of the identifiable net assets acquired, determined at the date of acquisition, and is not subject to amortization. Goodwill is shown under goodwill and intangible assets and is recognized at cost less accumulated impairment losses, which are not reversed. Gains or losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the operating segments, which is expected to benefit from the synergies of the combination. Each unit or group of units to which the goodwill is allocated represents the lowest level within the entity at which the goodwill is monitored for internal management purposes.

Goodwill impairment reviews are undertaken annually or more frequently if events or changes in circumstances indicate a potential impairment. The carrying value of goodwill is compared to the recoverable amount, which is the higher of value in use and the fair value less costs of disposal. Any impairment is recognized immediately as an expense and is not subsequently reversed.

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### **b. Development costs**

Research costs are recognized in income as incurred. Expenditures on development activities are recognized as intangible assets when such costs can be reliably measured, the product or process is technically and commercially feasible, potential future economic benefits are obtained and the Company intends also has sufficient resources to complete the development and to use or sell the asset. Their amortization is recognized in income by the straight-line method over the estimated useful life of the asset. Development expenditures that do not qualify for capitalization are recognized in income as incurred.

### **c. Intangible assets acquired in a business combination**

When an intangible asset is acquired in a business combination, it is recorded at fair value at the acquisition date. Subsequently, the intangible assets acquired in a business combination, such as: brands, client relations, intellectual property rights, non-competition agreements, among others, are recorded at cost less the accumulated amortization and the accumulated amount of impairment losses.

### **d. Other customer relationships**

The Company has recognized certain relationships with customers corresponding to the costs incurred to obtain the new contracts with certain OEMs (Original Equipment Manufacturers) and which will be applied to income over the lifetime of said contracts, which varies from 5 to 9 years. The amortization method used is based on the volume of units produced. At December 31, 2016, the Company recorded a charge of Ps2 for this item. There were no amortizations during 2015.

### **l. Impairment of non-financial assets**

Assets that have an indefinite useful life, for example goodwill, are not depreciable or amortizable and are subject to annual impairment tests. Assets that are subject to amortization are reviewed for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of the asset's fair value less costs of disposal and its value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels at which separately identifiable cash flows exist (cash generating units). Non-financial long-term assets other than goodwill that have suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

### **m. Income tax**

The amount of income taxes in the income statement represents the sum of the current and deferred income taxes.

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The income tax reflected in the consolidated income statement represents the tax incurred in the year, and the effects of deferred income tax determined in each subsidiary using the asset and liability method, applying the rate established by the enacted legislation or substantially enacted at the balance sheet date where the Company operate and generate taxable income. The applicable rates are applied to the total of the temporary differences resulting from comparing the accounting and tax bases of assets and liabilities in accordance with the years in which the deferred tax asset is realized or deferred tax liability is expected to be settled, considering when applicable, any tax loss carry forwards expected to be recoverable. The effect of a change in tax rates is recognized in the income of the period in which the rate change is substantially enacted.

Management periodically evaluates positions taken in tax returns with respect to situations in which the applicable law is subject to interpretation. Provisions are recognized when appropriate based on the amounts expected to be paid to the tax authorities.

Deferred tax assets are recognized only when it is probable that future taxable profits will exist against which the deductions for temporary differences can be taken.

The deferred income tax on temporary differences arising from investments in subsidiaries and associates is recognized, unless the period of reversal of temporary differences is controlled by Nemak and it is probable that the temporary differences will not reverse in the near future.

Deferred tax assets and liabilities are offset when a legal right exists and offset exists when the taxes are levied by the same tax authority.

### **n. Employee benefits**

#### **Defined contribution plans:**

A defined contribution plan is a pension plan under which the Company pays fixed contributions into a separate entity. The Company has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to their service in the current and past periods. The contributions are recognized as employee benefit expense when they are due.

#### **Defined benefit plans:**

##### **i. Pension plans**

A defined benefit plan is a plan which specifies the amount of the pension an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation.

The liability recognized in the balance sheet in respect of defined benefit plans is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using discount rates that are denominated in the currency in which the benefits will be paid, and have maturities that approximate the terms of the pension liability.

Remeasurements from adjustments and changes in actuarial assumptions are recognized directly in equity in other items of the comprehensive income in the year they occur.

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The Company determines the net finance expense (income) by applying the discount rate to the liabilities (assets) from net defined benefits.

Past-service costs are recognized immediately in the income statement.

#### **ii. Other post-employment benefits**

The Company provides medical benefits to retired employees after termination of employment. The right to access these benefits usually depends on the employee's having worked until retirement age and completing a minimum of years of service. The expected costs of these benefits are accrued over the period of employment using the same criteria as those described for defined benefit pension plans.

#### **iii. Termination benefits**

Termination benefits are payable when employment is terminated by the Company before the normal retirement date or when an employee accepts voluntary termination of employment in exchange for these benefits. The Company recognizes termination benefits in the first of the following dates: (a) when the Company can no longer withdraw the offer of these benefits, and (b) when the Company recognizes the costs from restructuring within the scope of the IAS 37 "Provisions, Contingent Liabilities and Contingent Assets" and it involves the payment of termination benefits. If there is an offer that promotes the termination of the employment relationship voluntarily by employees, termination benefits are valued based on the number of employees expected to accept the offer. Any benefits to be paid more than 12 months after the balance sheet date are discounted to their present value.

#### **iv. Short-term benefits**

The Company provides benefits to employees in the short term, which may include wages, salaries, annual compensation and bonuses payable within 12 months. Nemak recognizes an undiscounted provision when it is contractually obligated or when past practice has created an obligation.

#### **v. Employee participation in profits and bonuses**

The Company recognizes a liability and an expense for bonuses and employee participation in profits when it has a legal or assumed obligation to pay these benefits and determines the amount to be recognized based on the profit for the year after certain adjustments.

#### **o. Provisions**

Liability provisions represent a present legal obligation or a constructive obligation as a result of past events where an outflow of resources to meet the obligation is likely and where the amount has been reliably estimated. Provisions are not recognized for future operating losses.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the value of money over time and the risks specific to the obligation. The increase in the provision due to the passage of time is recognized as interest expense.

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When there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognized even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions for legal claims are recognized when the Company has a present obligation (legal or assumed) as a result of past events, it is likely that an outflow of economic resources will be required to settle the obligation and the amount can be reasonably estimated. At December 31, 2016 and 2015, the Company has not any provision.

### **p. Share-based payments**

ALFA (holding company) has compensation plans are based on the market value of its shares in favor of certain senior executives of the Company. The conditions for granting such compensation to the eligible executives include among other things, compliance with certain metrics such as the level of profit achieved, remaining in the Company for up to 5 years, etc. The Board of Directors has appointed a technical committee to manage the plan, and it reviews the estimated cash settlement of this compensation at the end of the year. The payment plan is always subject to the discretion of the senior management of ALFA. Adjustments to this estimate are charged or credited to the income statement.

The fair value of the amount payable to employees in respect of share-based payments which are settled in cash is recognized as an expense, with a corresponding increase in liabilities, over the period of service required. The liability is included under other liabilities and is adjusted at each reporting date and the settlement date. Any change in the fair value of the liability is recognized as compensation expense in the income statement.

### **q. Capital stock**

Nemak's common shares are classified as capital stock within equity. Incremental costs directly attributable to the issuance of new shares are included in equity as a deduction from the consideration received, net of tax. The capital stock includes the effect of inflation recorded up to December 31, 1997.

### **r. Comprehensive income**

Comprehensive income is composed of net income plus other capital reserves, net of taxes, which comprise the effects of the translation of foreign subsidiaries, the effects of derivative financial instruments for cash flow hedging, remeasurement of obligations for employee benefits, the effects of changes in the fair value of financial instruments available for sale, the equity in other items of comprehensive income of associates, and other items specifically required to be reflected in equity and which do not constitute capital contributions, reductions or distributions.

### **s. Segment reporting**

Segment information is presented consistently with the internal reporting provided to the Chief Executive Officer who is the highest authority in operational decision-making, resource allocation and assessment of operating segment performance.

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### **t. Revenue recognition**

Revenue comprises the fair value of the consideration received or receivable for the sale of goods and services in the normal course of operations. Revenue is shown net of estimated customer returns, rebates and similar discounts and after eliminating intercompany sales.

Revenue from the sale of goods and products are recognized when all and each of the following conditions are met:

- The risks and rewards of ownership have been transferred.
- The amount of revenue can be reliably measured.
- It is likely that future economic benefits will flow to the Company.
- The Company retains no involvement associated with ownership nor effective control of the sold goods.
- The costs incurred or to be incurred in respect of the transaction can be measured reasonably.

Revenue recognition criteria depend on the contractual conditions with its customers. In most cases depending of the agreements with each customer the risks and rewards of ownership are transferred when the goods are taken from the plant of the Company to the customers, in other cases the risks and rewards of ownership are transferred when the goods are delivered from the plant to the customers.

The Company estimates are based on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

### **u. Advanced payments**

Advanced payments mainly comprise insurance and the corporate fee paid to suppliers. These amounts are registered based on the contractual value and are carried to the income statement on a monthly basis during the life to which each advanced payment corresponds: the amount that corresponds to the portion to be recognized within the next 12 months is presented in current assets and the remaining amount is presented in non-current assets.

### **v. Earnings per share**

Earnings per share are calculated by dividing the profit attributable to the shareholders of the parent by the weighted average number of common shares outstanding during the year. At December 31, 2016 and 2015 there are no dilutive effects from financial instruments potentially convertible into shares.

### **w. Changes in accounting policies and disclosures**

The following accounting policies were adopted by the Company beginning January 1, 2016 and did not have a material impact on the Company:

- Annual improvements to the IFRS - cycle 2012-2014.
- Initiative of disclosures - Amendments to IAS 1.

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The adoption of these changes had no impact in the current period or any previous periods and it is not likely to affect future periods.

x. New accounting pronouncements

A new number of standards, amendments and interpretations to the accounting policies have been published, which are not effective for reporting periods at December 31, 2016, and have not been adopted in advance by the Company. The Company's assessment of the effects of these new standards and interpretations are detailed below:

IFRS 9 "Financial instruments", addresses the classification, measurement and recognition of financial assets and liabilities and introduces new rules for hedge accounting. In July 2014, the IASB made additional changes to the classification and measurement rules and also introduced a new impairment model. These last changes now comprise the entire new financial instruments standard. Following the approved changes, the Company no longer expects any impact from the new rules of classification, measurement and decrease of its financial assets or liabilities. There will be no impact on the Company's accounting from financial liabilities, since the new requirements only affect financial liabilities at fair value through income and the Company has no such liabilities. The new hedge rules pair up the Company's hedge accounting and risk management. As a general rule, the hedge accounting will be much easier to apply since the standard introduces an approach based on principles. The new standard introduces extensive disclosure requirements and changes in presentation, which will continue to be assessed by the Company. The new impairment model is a model of expected credit losses; therefore, it would result in advance recognition of credit losses. The Company continues assessing how its hedge agreements and impairment provisions are affected by the new rules. The standard is effective for the periods beginning on or after January 1, 2018. Early adoption is allowed.

IFRS 15 "Revenue from contracts with customers", is a new standard issued by the IASB for revenue recognition. This standard replaces IAS 18 "Revenues", IAS 11 "Construction contracts", as well as the interpretations to the aforementioned standards. The new standard is based on the fact that revenue should be recorded when the control over the good or different service is transferred to the customer, so that this control notion replaces the existing notion of risks and benefits.

The standard allows for a complete retrospective approach and a modified retrospective approach for its adoption. The Company is assessing which of the two approaches it can use and to date, it considers that the modified retrospective approach might be used for adoption. Under this approach the entities will recognize adjustments from the effect of initial application (January 1, 2018) in retained earnings in the financial statements at December 2018 without restating comparative periods, by applying the new rules to contracts effective as of January 1, 2018 or those that even when held in prior years continue to be effective at the date of initial application.

For disclosure purposes in the financial statements at 2018, the amounts of affected items must be disclosed, considering the application of the current revenue standard, as well as an explanation of the reason for the significant changes made.

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Management is assessing the new standard and has identified probable impacts, mainly in the automotive and telecommunication sectors. The most relevant issues being assessed by Management are mentioned below:

- Depending on the contractual agreement, contracts that are currently considered as separate might have to be combined.
- The Company will have to identify, in customer contracts, the promises of goods and services qualifying as different compliance obligations and compliance obligations might arise additional to those currently considered, or vice versa, which may result in changes at the time of the revenue recognition. Upon the distribution of revenues among each compliance obligation not previously identified, based on their related fair value, the amount of revenues to be recorded for each compliance obligation might also change, which could change the time of recognition of the compliance obligation, even though there is no change in the total amount of revenues per contract.
- The impact of the price structures included in the long-term contracts is currently under evaluation. In said structures, the prices of the parts are gradually decreased over the years, and can qualify as a material discount right requiring recognition from the moment of the first sale of parts, thus representing a change in revenue recognition. However, Management considers that the price structures involving decreases over the years is justified by greater efficiencies and cost cuts achieved, and therefore, forms part of the fair value of the price of parts, as a result of which, this item might represent no significant impact.
- With the new Agent and Principal guidelines, presentation of certain revenue could be gross rather than net.
- In the case of goods and services that under the new standard do not qualify as compliance obligations that may be separated, the costs to comply with the contract, such as production costs associated with these goods and services, may have to be capitalized instead of recognized as expenses when incurred.
- The Company is assessing if in any of the cases the time of revenue recognition might change from “at a point in time”, to “through time”, in case all standard conditions are met, when dealing with the manufacturing of goods without any alternative use for other customer, when there is a collection right for the work done.
- The guide of amendments to contracts can affect the manner by which they are recorded in the books of account. An analysis is currently underway to evaluate whether or not some of the amendments should be recognized, taking into account an accumulated adjustment rather than being prospective.
- At present, certain payments are made to customers, which Management is evaluating, to determining whether or not they qualify as costs under the new guidelines, to obtain a contract.

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IFRS 16 “Leases”. The IASB issued in January 2016 a new standard for lease accounting. This standard will replace current standard IAS 17, which classifies leases into financial and operating. IAS 17 identifies leases as financial in nature when the risks and benefits of an asset are transferred, and identifies the rest as operating leases. IFRS 16 eliminates the classification between financial and operating leases and requires the recognition of a liability showing future payments and assets for “right of use” in most leases. The IASB has included some exceptions in short-term leases and in low-value assets. The aforementioned amendments are applicable to the lease accounting of the lessee, while the lessor maintains similar conditions to those currently available. The most significant effect of the new requirements is shown in an increase in leasing assets and liabilities, also affecting the statement of income in depreciation expenses and financing of recorded assets and liabilities, respectively, and decreasing expenses relative to leases previously recognized as operating leases.

The standard is effective for periods beginning on or after January 1, 2019. In this stage, the Company has no plans to adopt the standard in advance.

At December 31, 2016, the Company is in the process of evaluating the impact of this new standard on its financial statements. The efforts made with regard to implementation of this standard is considerable.

There are no other additional standards, amendments, or interpretations issued but not effective that might have a significant impact on the Company.

### **Note 4 - Financial risk management:**

#### **4.1 Financial risk factors**

The Company's activities expose it to various financial risks: market risk (including foreign exchange, interest rate on cash flows and on fair value), credit risk, liquidity risk, and risks linked to supplies and products. Company's risk management plan considers the unpredictability of the financial markets and seeks to minimize the potential negative effects on its financial performance. Nemak utilizes derivative financial instruments to hedge certain risk exposures.

The objective is to protect the financial health of the business taking into account the volatility associated with foreign exchange and interest rates. Additionally, due to the nature of the industries in which it participates, the Company has entered into derivative hedges of raw material prices.

ALFA (the holding company) has a Risk Management Committee, which is formed by the Chairman of the Board, the Chief Executive Officer, the Chief Financial Officer of ALFA and a Financial Executive of ALFA who acts as technical secretary. The Committee oversees derivatives transactions proposed by the Company in which the maximum possible loss exceeds US\$1. This Committee supports both the Executive Director and the Chairman of the Company.

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All new derivative transactions that the Company proposes to make, and the renewal of existing derivatives, require approval by both the Company and ALFA in accordance with the following schedule of authorizations:

	<u>Possible Maximum Loss US\$</u>	
	<u>Individual transactions</u>	<u>Annual cumulative transactions</u>
Nemak's CEO	1	5
ALFA's Risk Management Committee	30	100
Finance Committee from Alfa's Board of Directors	100	300
ALFA's Board of Directors	>100	>300

The proposed transactions must meet certain criteria, including that the hedges are lower than exposures, and that they are the result of a fundamental analysis and properly documented. Sensitivity analyses and other risk analyses should be performed before the operation is executed.

a. Market risk

i. Exchange rate risk

The Company operates internationally and is exposed to foreign exchange risk, primarily related to the currencies other than the functional currency in which its subsidiaries operate, as described in Note 3. Nemak is exposed to foreign exchange risk arising from future commercial transactions in assets and liabilities in foreign currencies and investments abroad.

The respective exchange rates of the Mexican peso, the U.S. dollar and the euro are very important factors for the Company due to the effect they have on their results. Nemak estimates that approximately 56% of its sales are U.S. dollar denominated and 35% in Euro, either because they come from products that are exported from Mexico or because they come from products that are manufactured and sold abroad, or because even if sold in Mexico the price of such products are set based on international prices in foreign currencies such as the U.S. dollar or Euro.

Usually, a peso depreciation would result in an increase in the operating margin and a peso appreciation would result in a decrease in operating margin, each case, when is measured in pesos. However, although this correlation factor has appeared on several occasions in the recent past, there is no assurance that it will be repeated if the exchange rates between the Mexican peso and other currencies fluctuate again.

The Company has participated in operations with derivative financial instruments on exchange rates for the purpose of controlling the total comprehensive cost of its financing and the volatility associated with exchange rates. Additionally, it is important to note the high "dollarization" and "eurization" of Nemak's revenues, providing a natural hedge against its obligations in dollars and euros with respect to the level of income of such currencies. Based on the overall exchange rate exposure at December 31, 2016 and 2015, a 5% increase /decrease in the exchange rate MXN/USD, holding all other variables constant, would result in an effect on the income statement by Ps5 and Ps23, respectively.

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The risk management policy of the Company is to cover no more than the following percentages with respect to the projected exposure:

	<u>Current year</u>	<u>Prior year</u>
Interest rates	90	90
Commodities	90	90
Energy costs	65	65
Exchange rate for operating transactions	70	70
Exchange rate for financial transactions	90	90

The Company has certain investments in foreign operations, whose net assets are exposed to the risk of foreign currency translation. The currency exposure arising from the net assets of the Company's foreign operations are frequently managed through borrowings denominated in the relevant foreign currency.

#### **ii. Interest rate and cash flow risk**

Loans at floating rates expose the Company to interest rate risk on cash flows that are partially offset by cash held at floating rates. Loans at fixed rates expose the Company to interest rate risk at fair value. During 2016 and 2015, floating rate loans are mainly denominated in US dollars. At December 31, 2016, 40% of financing are denominated at fix rate, and 60% at floating rate. See Note 15.

At December 31, 2016 and 2015 if the interest rates on floating rate loans were increased/decreased by 10%, interest expense would increase/decrease by Ps10 and Ps10, respectively.

#### **b. Credit risk**

Credit risk is managed on a group basis, except for the credit risk related to accounts receivable balances. Each subsidiary is responsible for managing and analyzing credit risk for each of its new customers before setting the terms and conditions of payment. Credit risk is generated from cash and cash equivalents, derivative financial instruments and deposits with banks and financial institutions as well as credit exposure to customers, including receivables and committed transactions. If wholesale customers are rated independent, these are the ratings used. If there is no independent rating, the Company's risk control group evaluates the creditworthiness of the customer, taking into account their financial position, past experience and other factors.

Individual risk limits are determined based on internal and external ratings in accordance with limits set by the Board. The use of credit risk is monitored regularly.

During 2016 and 2015, credit limits were not exceeded and management does not expect losses in excess of the impairment recognized in the corresponding periods.

The impairment provision for doubtful accounts represents estimated losses resulting from the inability of customers to make required payments. In determining the allowance for doubtful accounts, significant estimates have to be made. Nemak performs ongoing credit evaluations of its customers and adjusts credit limits based upon payment history and the customer's current creditworthiness, as determined by a review of their current credit information.

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In addition, the Company considers a number of factors to determine the size and appropriate timing for the recognition and amount of allowances, including historical collection experience, customer base, current economic trends and the ageing of the accounts receivable portfolio.

#### **c. Liquidity risk**

Projected cash flows are determined at each operating entity of the Company and subsequently the finance department consolidates this information. The finance department of the Company continuously monitors the cash flow projections and liquidity requirements of the Company ensuring that sufficient cash and highly liquid investments are maintained to meet operating needs, as well as keeping some flexibility through available committed and uncommitted credit lines.

The Company regularly monitors and makes decisions ensuring that the limits or covenants set forth in debt contracts are not violated. The projections consider the financing plans of the Company, compliance with covenants, compliance with minimum liquidity ratios and internal legal or regulatory requirements.

The Company's treasury invests those funds in overnight deposits whose maturities or liquidity allow flexibility to meet the cash needs of the Company. At December 31, 2016 and 2015, the Company had cash and cash equivalents of Ps2,661 and Ps1,793, respectively, which are considered sufficient to adequately manage liquidity risk.

The following table analyzes the derivative and non-derivative, grouped according to their maturity, from the balance sheet date to the contractual maturity date. Derivative financial liabilities are included in the analysis if their contractual maturities are required to understand the timing of the Company's cash flows.

The amounts disclosed in the table are contractual undiscounted cash flows.

	<u>Less than 3 months</u>	<u>From 3 months to 1 year</u>	<u>From 1 year to 2 years</u>	<u>From 2 years to 5 years</u>	<u>More than 5 years</u>
December 31, 2016					
Trade and other accounts payable	Ps 17,544	Ps 1,836	Ps -	Ps -	Ps -
Bank loans	1,788	1,992	5,625	5,767	3,735
Senior Notes	284	568	568	1,421	11,184
Notes payables	3	12	10	66	12
Financial leases	7	29	29	81	56
	<u>Less than 3 months</u>	<u>From 3 months to 1 year</u>	<u>From 1 year to 2 years</u>	<u>From 2 years to 5 years</u>	<u>More than 5 years</u>
December 31, 2015					
Trade and other accounts payable	Ps 16,236	Ps 1,222	Ps -	Ps -	Ps -
Bank loans	420	577	1,676	9,370	3,463
Senior Notes	118	355	473	1,446	9,602
Notes payables	2	6	6	31	32
Financial leases	4	13	15	34	130

The Company expects to meet its obligations with cash flows generated by operations. Additionally Nemak has access to credit lines with various banks to meet possible requirements.

At December 31, 2016 and 2015, the Company has uncommitted short term credit lines unused for more than US\$867 (Ps17,916) and US\$629 (Ps10,823), respectively. Additionally, at December 31, 2016 and 2015, Nemak has committed medium-term credit lines of US\$349 (Ps7,212) and US\$302 (Ps5,196), respectively.

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### **d. Price risk of raw materials and derivatives**

Nemak utilizes significant amounts of aluminum in the form of scrap, as well as ingots as its main raw material. In order to mitigate the risks related to the volatility of the prices of this commodity, the Company has established agreements with its clients, whereby the variations of aluminum prices are transferred at the sales price of the products through a pre-established formula.

However, there is a residual risk since each OEM uses its own formula to estimate aluminum prices, which normally reflects market prices based on an average term that may range from one to three months. As a result, the basis used by each OEM to calculate the prices of aluminum alloys may differ from the ones used by the Company to buy aluminum, which could negatively impact its business, financial position and the results of its operations.

The Company uses large volumes of natural gas in their production processes. This consumption has been growing as the volume of their end products increase. In order to mitigate exposure to the price of this material, the Company makes from time to time, some natural gas hedging using derivative instruments. At December 31, 2016 and 2015, the Company does not have derivative financial instruments to hedge these risks. See Note 10.

Based on the exposure of aluminum price at December 31, 2016 and 2015, a hypothetical increase (decrease) of 10% applied at fair value and maintaining all other variables constant, such as exchange rates, the increase (decrease) would result in an impact at December 31, 2016 and 2015 in the income statement of Pso and Ps2, respectively.

### **4.2 Equity risk management**

The Company's objectives when managing equity are to safeguard the Company's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders and benefits to other interested parties, as well as maintain an optimal capital structure so as to reduce the cost of capital.

To maintain or adjust the equity structure, the Company may adjust the amount of dividends paid to shareholders, return equity to shareholders, issue new shares or sell assets to reduce debt.

Nemak monitors equity based on the degree of leverage. This percentage is calculated by dividing total liabilities by total equity.

The financial ratio of total liabilities/total equity was 1.50 and 1.58, at December 31, 2016 and 2015, respectively.

### **4.3 Fair value estimation**

The following is an analysis of financial instruments measured by the fair value valuation method. The three different levels used are presented below:

- Level 1: Quoted prices for identical instruments in active markets.
- Level 2: Other valuations including quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in inactive markets, and valuations using models where all significant data are observable in active markets.

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- Level 3: Valuations made through techniques wherein one or more of their significant data inputs are unobservable.

### **Level 1**

The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. A market is considered active if quoted prices are clearly and regularly available from a stock exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regular market transactions at arm-length conditions. The trading price used for financial assets held by the Company is the current bid price.

### **Level 2**

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. These valuation techniques maximize the use of observable market data when available and rely as little as possible on estimates specific to the Company. If all significant inputs required to measure an instrument at fair value are observable, the instrument is classified at Level 2.

The fair values represent a mathematical approximation of their market value at the date of measurement. The market value estimate consists in considering the future rates corresponding to the underlying asset. These future rates are obtained from observable market curves of related sources (such as, but not exclusively, CMAI, OPIS). These estimates are generally confirmed with valuations of considerations issued by each instrument.

### **Level 3**

If one or more of the significant inputs is not based on observable market data, the instrument is classified at Level 3.

Specific valuation techniques used to value financial instruments include:

- Market quotations or offers from retailers for similar instruments.
- The fair value of interest rate swaps calculated as the present value of estimated future cash flows based on observable yield curves.
- The fair value of forward exchange contracts determined using the exchange rates on the balance sheet date, with the resulting value discounted to present value.
- Other techniques, such as the analysis of discounted cash flows, which are used to determine fair value for the remaining financial instruments.

The financial assets included within this level are only the financial assets available for sale, which correspond to investment in shares of companies that are not listed in an active market; therefore, the fair value may not be reliably determined.

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At December 31, 2016 and 2015, there are financial assets available for sale in the level 3 classification, totaling Ps71 and Ps70, respectively. The following table shows the movements in Level 3 instruments:

	<u>Financial assets available for sale</u>
Final balance at January 1, 2015 (Note 14)	Ps 70
Exchange difference	<u>-</u>
Final balance at December 31, 2015 (Note 14)	70
Exchange difference	<u>1</u>
Final balance at December 31, 2016 (Note 14)	<u>Ps 71</u>

At December 31, 2016 and 2015, the Company shows no financial assets or financial liabilities measured at fair value and therefore, there are no financial assets or liabilities classified in Levels 1 and 2.

There are no transfers between Levels for the periods reported on.

#### **Note 5 - Critical accounting estimates and judgments:**

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

##### **5.1 Critical accounting estimates and judgments**

The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below:

##### **a. Estimated impairment of goodwill**

The Company uses significant judgment to group its UGES, on the basis of aspects such as operation of the commercial area and sales strategy, production allocation, the analysis of operating flows and policies on indebtedness and the analysis of the legal structure.

The identification and measurement of impairment to goodwill involves the estimation of fair values. These estimates and assumptions could have a significant impact on whether or not an impairment charge is recognized and also the magnitude of any such charge. The Company performs valuation analyses with the assistance of third parties and considers relevant internal data, as well as other market information that is publicly available.

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Estimates of fair value are primarily determined using discounted cash flows and market comparisons. These approaches use significant estimates and assumptions, including projected future cash flows (including timing), discount rates reflecting the inherent risk in future cash flows, perpetual growth rates, determination of appropriate market comparables and the determination of whether a premium or discount should be applied to comparables. Inherent in these estimates and assumptions is a certain level of risk, which the Company believes has considered in their valuations. Nevertheless, if future actual results differ from estimates, a possible impairment charge may be recognized in future periods related to the write-down of the carrying value of other intangibles in addition to the amounts recognized previously. See Note 12.

### **b. Income tax**

The Company is subject to income taxes in numerous jurisdictions. Significant judgment is required in determining the worldwide provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain. The Company recognizes liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current and deferred income tax assets and liabilities in the period in which such determination is made.

As part of the preparation processes of the financial statements, the Company is required to calculate income tax. This process involves estimating the real exposure of the current tax, as well as evaluating the temporary differences resulting from treating items differently, such as impairment of trade accounts receivable, deferred assets, inventories, property, plant and equipment, accumulated expenses and tax loss carryforwards, for tax and accounting purposes.

These differences result in deferred tax assets and liabilities included within the statement of financial position. The Company then evaluates the probability to recover its deferred tax assets. The Company recognizes deferred tax assets for all deductible temporary differences, insofar as there is a probability that the entity has future tax benefits against which to apply these deductible temporary differences. The most recent projections of available profits are used to determine future tax benefits.

### **c. Pension benefits**

The present value of the pensions obligations depend on several factors that are determined on an actuarial basis using a variety of assumption. Assumptions used in the determination of the net cost (income) for pensions, includes the discount rate. Any change in these assumptions will have an impact on the carrying value of pension obligations. See Note 18.

The Company determines the adequate discount rate at each year end. This interest rate should be used to determine the present value of cash outflows required to settle expected future pension obligations. In determining the appropriate discount rate, the Company considers the discounted interest rate in conformity with IAS 19 "Employee benefits" denominated in the currency in which the benefits will be paid and that have terms to maturity approximating the terms of the related pension obligation. Other key assumptions for pension obligations are based, partly on current market conditions.

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### **d. Commitments and contingencies**

The Company makes judgments regarding the measurement and recognition of provisions and the exposures to contingent liabilities related to pending litigations or other pending complaints subject to negotiation of settlement, mediation, arbitration or regulation of the government, as well as other contingent liabilities. The Company makes judgments to assess the probability of a pending complaint to be effective or to result in the recognition of a liability, as well as to quantify the possible settlement range. Due to the uncertainty inherent to this assessment process, actual losses may be different to the originally estimated provision.

Contingencies are recorded as provisions when it is likely that a liability has been incurred and the amount of the loss is reasonably estimable. It is not practical to estimate sensitivity to potential losses if other assumptions were used to record these provisions, due to the number of underlying assumptions and the range of possible reasonable outcomes regarding potential actions by third parties, such as regulators, both in terms of loss probability and estimates of such loss.

### **5.2 Critical judgments in applying the entity's accounting policies**

#### **a. Revenue recognition**

The Company has recognized revenue amounting to Ps79,244 and Ps70,891, for the sale of products to OEM's during 2016 and 2015, respectively. The buyer has the right to return the goods if they are dissatisfied. The Company believes that, based on past experience with similar sales, the rate of returned products will not exceed 3% of revenue. The Company has, therefore, recognized revenue on these transactions with a corresponding provision for estimated returns. If the estimate changes by 1%, the revenue would have been reduced/increased by Ps792 and Ps709, during 2016 and 2015, respectively.

### **Note 6 - Cash and cash equivalents:**

Cash and cash equivalents consist of the following:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Cash at bank and in hand	Ps 2,115	Ps 1,270
Short-term bank deposits	<u>546</u>	<u>523</u>
Total cash and cash equivalents	<u>Ps 2,661</u>	<u>Ps 1,793</u>

For purposes of the cash flow statement the cash and cash equivalents include the following items:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Cash and cash equivalents	Ps 2,661	Ps 1,793
Bank overdrafts (Note 17)	<u>-</u>	<u>(1)</u>
Cash and cash equivalents at end of year	<u>Ps 2,661</u>	<u>Ps 1,792</u>

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### **Note 7 - Restricted cash**

The value of restricted cash is composed as follows:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Current <sup>1</sup>	Ps 474	Ps 323
Non-current (Note 13)	<u>12</u>	<u>10</u>
Restricted cash	<u>Ps 486</u>	<u>Ps 333</u>

<sup>1</sup> The Company has certain legal disputes with the Brazilian tax authorities. The main dispute is related to the application of certain criteria and other minor contingencies related to labor and social security issues. In this process, the company made deposits by the amounts in dispute and is waiting for a final decision to their claims. The amounts mentioned above are Ps474 in 2016 and Ps323 in 2015. See Note 28b.

### **Note 8 - Trade and other receivables, net:**

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Current:		
Trade receivables	Ps 5,071	Ps 4,304
Receivables from related parties (Note 26)	3,100	3,407
Value-added tax and other taxes	2,997	2,811
Sundry debtors	465	231
Provision for impairment	<u>(52)</u>	<u>(33)</u>
	<u>Ps 11,581</u>	<u>Ps 10,720</u>
Non-current:		
Non-current related parties receivables (Note 26)	<u>Ps 720</u>	<u>Ps -</u>

Customers and other accounts receivable include past-due balances of Ps1,774 and Ps1,014 at December 31, 2016 and 2015, respectively.

At December 31, 2016 and 2015, there are impaired accounts receivable of (Ps52) and (Ps33), which have been provisioned in their entirety.

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The analysis by age of the balances due from customers and other receivables not covered by impairment provisions is as follows:

	<u>December 31</u>	
	<u>2016</u>	<u>2015</u>
1 to 30 days	Ps1,091	Ps 638
31 to 90 days	438	141
91 to 180 days	138	100
More than 180 days	<u>107</u>	<u>135</u>
Total	<u>Ps1,774</u>	<u>Ps1,014</u>

Movements in the provision for impairment of customers and other receivables are analyzed as follows:

	<u>2016</u>	<u>2015</u>
Initial balance (January 1)	(Ps 33)	(Ps28)
Provision for impairment of customers and other receivables	(51)	(34)
Receivables written off during the year	27	18
Unused amounts reversed	<u>5</u>	<u>11</u>
Final balance (December 31)	<u>(Ps 52)</u>	<u>(Ps33)</u>

Increases in the provision for impairment of customers and other receivables are recorded in the statement of income under sales expenses.

At December 31, 2016 and 2015, the maximum risk of accounts receivable is their carrying value.

#### **Note 9 - Inventories:**

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Raw material and other consumables	Ps 8,278	Ps 7,026
Production in process	1,589	1,416
Finished goods	<u>1,917</u>	<u>1,225</u>
	<u>Ps11,784</u>	<u>Ps 9,667</u>

The cost of inventories recorded in income and included in cost of sales amounted to Ps65,345 and Ps59,143, for 2016 and 2015, respectively.

In the years ended on December 31, 2016 and 2015, damaged, slow-moving and obsolete inventory was charged to cost of sales in the amount of Ps4 and Ps26, respectively.

At December 31, 2016 and 2015, there were no inventories provided in guarantee.

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### **Note 10 - Financial Instruments:**

#### **a. Financial instruments by category**

	At December 31, 2016				
	Receivables and liabilities at amortized cost	Financial assets and liabilities at fair value with changes in income	Available for sale	Derivative contracted as hedge	Total
Financial assets:					
Cash and cash equivalents	Ps 2,661	Ps -	Ps -	Ps -	Ps 2,661
Restricted cash	486	-	-	-	486
Trade and other accounts receivable	12,301	-	-	-	12,301
Financial assets available for sale	-	-	71	-	71
	<u>Ps 15,448</u>	<u>Ps -</u>	<u>Ps 71</u>	<u>Ps -</u>	<u>Ps 15,519</u>
Financial liabilities:					
Debt	Ps 29,009	Ps -	Ps -	Ps -	Ps 29,009
Trade and other payables	18,894	-	-	-	18,894
	<u>Ps 47,903</u>	<u>Ps -</u>	<u>Ps -</u>	<u>Ps -</u>	<u>Ps 47,903</u>

	At December 31, 2015				
	Receivables and liabilities at amortized cost	Financial assets and liabilities at fair value with changes in income	Available for sale	Derivative contracted as hedge	Total
Financial assets:					
Cash and cash equivalents	Ps 1,793	Ps -	Ps -	Ps -	Ps 1,793
Restricted cash	333	-	-	-	333
Trade and other accounts receivable	10,720	-	-	-	10,720
Advanced payments	277	-	-	-	277
Financial assets available for sale	-	-	70	-	70
	<u>Ps 13,113</u>	<u>Ps -</u>	<u>Ps 70</u>	<u>Ps -</u>	<u>Ps 13,183</u>
Financial liabilities:					
Debt	Ps 22,710	Ps -	Ps -	Ps -	Ps 22,710
Trade and other payables	16,515	-	-	-	16,515
	<u>Ps 39,225</u>	<u>Ps -</u>	<u>Ps -</u>	<u>Ps -</u>	<u>Ps 39,225</u>

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#### **b. Credit quality of financial assets**

The credit quality of financial assets that are neither past due nor impaired can be assessed by reference to external credit ratings (if available) or to historical information about counterparty default rates:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Trade and other receivables and related parties		
Counterparties with external credit rating:		
"A+"	Ps 248	Ps 218
"A"	20	16
"A-"	620	48
"BBB+"	3,472	243
"BBB"	2,054	87
"BBB-"	532	2,088
"BB+"	238	-
"BB"	1,179	332
"BB-"	-	740
Other categories	<u>31</u>	<u>10</u>
	<u>8,394</u>	<u>3,782</u>
Counterparties without external credit rating:		
"Type Y clients"	<u>3,239</u>	<u>6,971</u>
Total unimpaired accounts receivable	<u>Ps 11,633</u>	<u>Ps 10,753</u>
Cash and cash equivalents:		
"A+"	Ps 18	Ps 28
"A"	123	217
"A-"	1,063	47
"BBB+"	207	128
"BBB"	566	592
"BBB-"	33	5
"BB+"	6	93
Other categories	<u>645</u>	<u>683</u>
	<u>Ps 2,661</u>	<u>Ps 1,793</u>

Group Y - clients/current related parties (more than 6 months) without noncompliance in the past.

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#### **c. Fair value of financial assets and liabilities**

The amounts of cash and cash equivalents, restricted cash, trade and other receivables, other current assets, suppliers and other payables, outstanding debt, provisions and other current liabilities approximate their fair value due to their short maturity. The carrying value of these accounts represents the expected cash flow.

The carrying value and estimated fair value of financial assets and financial liabilities carried at amortized cost are as follows:

	<u>At December 31, 2016</u>		<u>At December 31, 2015</u>	
	<u>Carrying amount</u>	<u>Fair value</u>	<u>Carrying amount</u>	<u>Fair value</u>
Financial assets:				
Non-current accounts receivable	Ps 720	Ps 653	Ps -	Ps -
Financial liabilities:				
Bank loans	15,776	15,760	13,611	13,652
Peso Bond and other liabilities	11,380	11,256	8,876	8,930

The estimated fair values were determined based on discounted cash flows and these fair values are considered Level 3. These fair values do not consider the current portion of financial assets and liabilities, since the current portion approximates its fair value.

#### **d. Derivative financial instruments**

The effectiveness of derivative financial instruments designated as hedges is measured periodically. At December 31, 2016 and 2015, the Company has no derivative financial instruments operation contracted.

Notional amounts related to derivative financial instruments reflect the contracted reference volume; however they do not reflect the amounts at risk with respect to future cash flows. The amounts at risk are generally limited to the unrealized profit or loss from the market valuation of such instruments, which may vary according to changes in the market value of the underlying, its volatility and the credit quality of the counterparties.

At December 31, 2016, the principal obligations which the Company was subject to, depend on the type of contract and the conditions established in each one of the derivative financial instruments in force at this date.

Trading derivatives are classified as current assets or liabilities. The fair value of hedges is classified as a non-current asset or liability if the remaining maturity of the hedged item is more than 12 months and as a current asset or liability if the remaining maturity of the hedged item is less than 12 months.

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During the last quarter of the year 2015, the following changes to the company's derivative financial instruments occurred:

**a. Cancellation of Cross Currency Swap MXN / USD:**

In December 2015, the Company paid in advance the total of its Peso Bond amounting to Ps3,500. Consistent with this prepayment, it also fully canceled the "Cross Currency Swap" which converted via derivatives, the loan from MXN to USD. The "Cross Currency Swap" was acquired as a hedging transaction at an average exchange rate of Ps12.30, therefore Ps3,500 were converted to US\$285 (Ps4,904).

The cancellation of the derivative resulted in an cash outflow of US\$83 (Ps1,412), amount recorded in the statement of income; however, it should be noted that the exchange rate MXN / USD at the time of completion was Ps17.01, so Ps3,500 equivalent at that time to US\$206 (Ps3,504). These derivatives were designated as fair value hedges. See Note 2.

**b. Cancellation of Cross Currency Swap EUR-USD:**

In November 2015, the Company terminated in advance a trading derivative that had contracted since 2012 in order to increase exposure to the EUR, given the growing activities in that region. The transaction was agreed at a level of exchange of US\$1.25 per euro. The instrument had a remaining balance of €41 and final maturity in 2016. At the time of cancellation, the exchange rate USD / EURO was approximately 1.06 resulting in a cash redemption value in favor of Nemak of US\$5.3 (Ps89). This effect was recorded in the statement of income.

**c. Cancellation of natural gas derivative:**

In December 2015, Nemak early terminated a hedge operation on approximately 40% of its volume of consumption of energy for its operations in North America that had been contracted for the period 2016-2020. The early cancellation was decided in anticipation of further declines in the price of this commodity. The termination of these hedges resulted in a cash outflow for Nemak of US\$27.7 (Ps476). At 31 December 2015, the balance in accumulated other comprehensive income related to this coverage is Ps329. This amount will be reclassified to income statement as the forecasted transaction were to take place.

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**Note 11 - Property, plant and equipment:**

<u>Year ended December 31, 2015</u>	<u>Land</u>	<u>Buildings and constructions</u>	<u>Machinery and equipment</u>	<u>Transportation equipment</u>	<u>Furniture and office equipment</u>	<u>Construction in progress</u>	<u>Other fixed assets</u>	<u>Total</u>
Opening balance	Ps 971	Ps 5,734	Ps 20,607	Ps 51	Ps 370	Ps 4,272	Ps 530	Ps 32,535
Exchange differences	104	635	2,435	6	46	342	3	3,572
Additions	174	6	3	0	1	6,129	32	6,344
Disposals and write downs	(5)	(1)	(66)	(0)	(0)	-	(7)	(79)
Depreciation charge for the year	-	(319)	(3,612)	(32)	(146)	-	-	(4,108)
Transfers	2	546	4,319	36	176	(5,195)	117	0
At December 31, 2015	Ps 1,246	Ps 6,601	Ps 23,687	Ps 61	Ps 446	Ps 5,548	Ps 675	Ps 38,263
Cost	Ps 1,246	Ps 10,379	Ps 52,842	Ps 266	Ps 1,433	Ps 5,548	Ps 675	Ps 72,388
Accumulated depreciation	-	(3,778)	(29,155)	(205)	(987)	-	-	(34,125)
Net carrying value at December 31, 2015	Ps 1,246	Ps 6,601	Ps 23,687	Ps 61	Ps 446	Ps 5,548	Ps 675	Ps 38,263
<u>Year ended December 31, 2016</u>								
Opening balance	Ps 1,246	Ps 6,601	Ps 23,687	Ps 61	Ps 446	Ps 5,548	Ps 675	Ps 38,263
Exchange differences	264	1,346	4,689	13	98	1,036	116	7,563
Additions	-	(3)	1,193	0	14	8,110	18	9,332
Additions due to business acquisitions	132	129	825	7	6	124	(0)	1,223
Disposals and write downs	-	(1)	(901)	(0)	(1)	(6)	4	(905)
Depreciation charge for the year	-	(402)	(4,545)	(28)	(164)	-	-	(5,139)
Transfers	34	495	4,550	21	247	(5,480)	(110)	(243)
At December 31, 2016	Ps 1,676	Ps 8,165	Ps 29,498	Ps 74	Ps 646	Ps 9,332	Ps 703	Ps 50,094
Cost	Ps 1,676	Ps 13,564	Ps 69,308	Ps 339	Ps 2,012	Ps 9,332	Ps 703	Ps 96,934
Accumulated depreciation	-	(5,399)	(39,810)	(265)	(1,366)	-	-	(46,840)
Net carrying value at December 31, 2016	Ps 1,676	Ps 8,165	Ps 29,498	Ps 74	Ps 646	Ps 9,332	Ps 703	Ps 50,094

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Of the total depreciation expense of Ps4,873 and Ps3,932, were charged to cost of sales, Ps2 and Ps1, to selling expenses and Ps264 and Ps178, to administrative expenses in 2016 and 2015, respectively.

At December 31, 2016 and 2015 there were no pledged property, plant and equipment.

Assets under finance leases comprise the following amounts in which the Company is the lessee:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Cost - capitalized financial lease	Ps 464	Ps 414
Accumulated depreciation	<u>(225)</u>	<u>(174)</u>
Carrying value, net	<u>Ps 239</u>	<u>Ps 240</u>

The Company has entered into various non-cancellable capital lease agreements as lessee. The lease terms are between 5 and 20 years, and the ownership of the assets lies with the Company.

The other fixed assets are integrated by spare parts, land improvements and other fixed assets.

### **Note 12 - Goodwill and intangible assets, net:**

	<u>Development costs</u>	<u>Customer relationships</u>	<u>Software and licenses</u>	<u>Trademarks and patents</u>	<u>Goodwill</u>	<u>Total</u>
<u>Cost</u>						
At January 1, 2016	Ps 4,448	Ps2,023	Ps 515	Ps 93	Ps 5,187	Ps12,265
Exchange differences	1,615	121	103	19	649	2,507
Additions	851	921	169	0	0	1,942
Disposals	<u>(3)</u>	<u>(45)</u>	<u>(53)</u>	<u>0</u>	<u>0</u>	<u>(101)</u>
At December 31, 2016	<u>Ps 6,911</u>	<u>Ps3,020</u>	<u>Ps 734</u>	<u>Ps 112</u>	<u>Ps 5,837</u>	<u>Ps16,613</u>
At January 1, 2015	Ps 3,078	Ps1,171	Ps 665	Ps 80	Ps 4,764	Ps 9,758
Exchange differences	404	290	(169)	13	423	961
Additions	966	562	22	-	-	1,550
Disposals	<u>0</u>	<u>0</u>	<u>(3)</u>	<u>-</u>	<u>-</u>	<u>(3)</u>
At December 31, 2015	<u>Ps 4,448</u>	<u>Ps2,023</u>	<u>Ps 515</u>	<u>Ps 93</u>	<u>Ps 5,187</u>	<u>Ps12,266</u>
<u>Accumulated amortization</u>						
At January 1, 2016	(Ps 1,901)	(Ps 606)	(Ps 450)	(Ps 93)	Ps 0	(Ps 3,050)
Amortizations	(505)	(111)	(146)	0	0	(762)
Disposals	1	0	28	0	0	29
Exchange differences	<u>(524)</u>	<u>(108)</u>	<u>(122)</u>	<u>(19)</u>	<u>0</u>	<u>(773)</u>
At December 31, 2016	<u>(Ps 2,929)</u>	<u>(Ps 825)</u>	<u>(Ps 690)</u>	<u>(Ps 112)</u>	<u>Ps 0</u>	<u>(Ps 4,556)</u>
At January 1, 2015	(Ps 1,256)	(Ps 508)	(Ps 381)	(Ps 80)	Ps -	(Ps 2,225)
Amortizations	(388)	(63)	(48)	-	-	(499)
Disposals	0	0	3	-	-	3
Exchange differences	<u>(257)</u>	<u>(35)</u>	<u>(24)</u>	<u>(13)</u>	<u>-</u>	<u>(329)</u>
At December 31, 2015	<u>(Ps 1,901)</u>	<u>(Ps 606)</u>	<u>(Ps 450)</u>	<u>(Ps 93)</u>	<u>Ps -</u>	<u>(Ps 3,050)</u>

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	<u>Development costs</u>	<u>Customer relationship</u>	<u>Software and licenses</u>	<u>Trademarks and patents</u>	<u>Goodwill</u>	<u>Total</u>
<u>Net carrying value</u>						
Cost	Ps 6,911	Ps3,020	Ps 734	Ps 112	Ps 5,837	Ps16,613
Accumulated amortization	<u>(2,929)</u>	<u>(825)</u>	<u>(690)</u>	<u>(112)</u>	<u>0</u>	<u>(4,556)</u>
At December 31, 2016	<u>Ps3,982</u>	<u>Ps2,195</u>	<u>Ps 44</u>	<u>Ps 0</u>	<u>Ps5,837</u>	<u>Ps12,057</u>
Cost	Ps 4,448	Ps2,023	Ps 515	Ps 93	Ps 5,187	Ps12,266
Accumulated amortization	<u>(1,901)</u>	<u>(606)</u>	<u>(450)</u>	<u>(93)</u>	<u>-</u>	<u>(3,050)</u>
At December 31, 2015	<u>Ps2,547</u>	<u>Ps1,417</u>	<u>Ps 65</u>	<u>Ps 0</u>	<u>Ps5,187</u>	<u>Ps 9,216</u>

Of the total amortization expense, Ps521 and Ps351, were charged to cost of sales, Ps205 and Ps143, to administrative expenses, Ps7 and Ps5 to selling expenses, in 2016 and 2015, respectively.

Research expenses incurred and recorded in the results of 2016 and 2015 were Ps11 Ps4, respectively.

### **Effect of the change in accounting policy**

At December 31, 2015, costs incurred to obtain new contracts with certain OEMs were shown in the other non-current assets line item in the statement of financial position. At December 31, 2016, as a result of the analysis conducted by Management, it is concluded that classification as an intangible asset (other relationships with customers) best reflects the economic substance of the transaction. The retrospective effects of said changes in accounting policies have an effect only on the statement of financial position, as shown below:

	<u>Previously reported</u>	<u>Reclassified balance</u>
Goodwill and intangible assets	Ps 8,032	Ps 9,216
Other non-current assets	Ps 1,240	Ps 56

Additionally, Note 13 to these consolidated financial statements was modified due to aforementioned reclassification.

### **Impairment testing of goodwill**

Goodwill is allocated to operating segments that are expected to benefit from the synergies of the business combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units, as follows:

	<u>North America</u>	<u>Europe</u>	<u>Rest of the world</u>	<u>Total</u>
Closing balance January 1, 2015	Ps 2,196	Ps1,966	Ps 602	Ps 4,764
Exchange differences	<u>20</u>	<u>121</u>	<u>48</u>	<u>189</u>
Closing balance December 31, 2015	Ps 2,216	Ps2,087	Ps 650	Ps 4,953
Exchange differences	<u>398</u>	<u>371</u>	<u>115</u>	<u>884</u>
Closing balance December 31, 2016	<u>Ps 2,614</u>	<u>Ps2,458</u>	<u>Ps 765</u>	<u>Ps 5,837</u>

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The estimated gross margin has been budgeted based on past performance and market development expectations. The growth rate used is consistent with the projections included in the industry reports. The discount rate used is before taxes and it reflects the inherent risk in future cash flows.

The recoverable amount of all cash generating units has been determined based on fair value less costs of disposal considering a market participant's perspective. These calculations use cash flow projections based on pre-tax financial budgets approved by management covering 5 year period. Cash flows beyond the 5 year period are extrapolated using the estimated growth rates stated below.

The key assumptions used in calculating the fair value less costs of disposal in 2016 were as follows:

	<u>North America</u>	<u>Europe</u>	<u>Rest of the world</u>
Estimated gross margin	24.21%	20.87%	15.10%
Growth rate	1.50%	1.50%	2.40%
Discount rate	9.20%	8.70%	9.40%

The key assumptions used in calculating the fair value less costs of disposal in 2015 were as follows:

	<u>North America</u>	<u>Europe</u>	<u>Rest of the world</u>
Estimated gross margin	18.99%	15.16%	5.42%
Growth rate	1.50%	1.50%	2.40%
Discount rate	9.62%	9.62%	9.40%

With regard to the calculation of the fair value of the cash generating units, the Company considers that a possible change in the key assumptions used, would not cause the carrying value to materially exceed their value in use.

#### **Note 13 - Other non-current assets:**

	<u>At December 31,</u>	
	<u>2016</u>	<u>2015</u>
Restricted cash	Ps 12	Ps 10
Available for sale financial assets <sup>(1)</sup>	71	70
Investment in associates	415	303
Other assets	<u>97</u>	<u>56</u>
Total other non-current assets	<u>Ps 595</u>	<u>Ps 439</u>

<sup>(1)</sup> Available for sale financial assets are investment in shares of companies not listed on the market (See Note 4.3). No impairment loss was recognized as of December 31, 2016 and 2015.

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The accumulated summarized financial information for associates of the group accounted for by the equity method, not considered material, is as follows:

	<u>2016</u>	<u>2015</u>
Comprehensive income, equal to net profit	<u>Ps 55</u>	<u>Ps 48</u>

There are no contingent liabilities related to the investment of the group in the associates.

#### **Note 14 - Trade and other payables:**

	<u>At December 31,</u>	
	<u>2016</u>	<u>2015</u>
Suppliers	Ps 15,006	Ps 11,992
Advance from customers	505	687
Other taxes and social security benefits	779	682
Related parties (Note 26)	54	50
Other accounts and accumulated expenses payables	<u>2,550</u>	<u>3,104</u>
	<u>Ps 18,894</u>	<u>Ps 16,515</u>

#### **Note 15 - Debt:**

	<u>At December 31,</u>	
	<u>2016</u>	<u>2015</u>
Current:		
Bank loans <sup>(1)</sup>	Ps 1,788	Ps 228
Current portion of non-current debt	1,634	725
Notes payable <sup>(1)</sup>	<u>277</u>	<u>-</u>
Current debt	<u>Ps 3,699</u>	<u>Ps 952</u>
Non-current:		
Unsecured bank loans	Ps 16,443	Ps 13,566
Financial lease	203	197
Other:		
In foreign currency:		
USD Bond	10,194	8,644
Related parties:		
In local currency:		
Other	<u>104</u>	<u>76</u>
	26,944	22,483
Less: current portion of non-current debt	<u>(1,634)</u>	<u>(725)</u>
Non-current debt	<u>Ps 25,310</u>	<u>Ps 21,758</u>

<sup>(1)</sup> At December 31, 2016 and 2015, short-term bank loans and notes payable bore interest at an average rate of 3.84% and 3.72%, respectively.

The fair value of current bank loans and notes payable approximate their carrying value, since the discount effect is immaterial.

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The carrying amounts, terms and conditions of non-current debt were as follows:

Description	Currency	Contractual value	Costs of debt issuance	Interest payable	Balance at december 31, 2016	Balance at december 31, 2015	Inception date DD/MM/AAAA	Maturity date DD/MM/AAAA	Interest rate
Club Deal (Citi) <sup>(1)</sup>	USD	4,449	(22)	9	Ps 4,436	Ps 4,073	02/12/2013	02/12/2018	2.34%
Club Deal-(Citi) <sup>(1)</sup>	EUR	869	(5)	1	865	814	02/12/2013	02/12/2018	1.50%
Club Deal-(BBVA) <sup>(2)</sup>	USD	5,203	(27)	14	5,190	4,316	13/11/2015	13/11/2020	2.07%
Club Deal-(BBVA) <sup>(2)</sup>	EUR	978	(5)	2	975	835	13/11/2015	13/11/2020	1.25%
Bancomext LP	USD	2,477	(9)	3	2,471	2,062	23/12/2015	23/12/2025	3.39%
Nafin LP	USD	1,653	(7)	1	1,647	1,376	29/12/2015	29/12/2025	3.40%
Unicredit Turkey	EUR	741	-	0	741	-	28/12/2016	28/12/2019	1.25%
Brazil	BRL	76	-	15	91	88	31/01/2015	15/01/2025	8.50%
Modellbau	EUR	27	-	-	27	-	30/04/2009	30/09/2017	1.82%
Other									
Unsecured bank loans		16,473	(75)	45	16,442	13,564			
Senior Notes <sup>(3)</sup>	USD	10,123	(137)	209	10,195	9,644	28/02/2013	28/02/2023	5.50%
Financial lease:									
EUA	USD	1	-	-	1	4	01/01/2013	01/09/2017	10.64%
China	RMB	200	-	-	200	190	06/09/2006	28/02/2023	6.45%
Russia	RUR	2	-	-	2	2	01/08/2014	30/04/2018	4.05%
Total financial lease		203	-	-	203	196			
Other liabilities		104	-	-	104	77			
Total		26,903 <sup>(4)</sup>	(212)	254	26,944	22,483			
Less: current portion									
Of non-current debt					(1,634)	(725)			
Non current debt					Ps 25,310	Ps 21,758			

(1) Club Deal (Citi) in USD and EUR accrues at the LIBOR+1.5% and EURIBOR+1.5%, respectively.

(2) Club Deal (BBVA) in USD and EUR accrues at the LIBOR+1.25% and EURIBOR+1.25%, respectively.

(3) Senior Notes at a fixed interest rate of 5.5%

(4) At the exchange rate prevailing at the period end.

At December 31, 2016, the annual maturities of non-current debt are as follows:

	2017	2018	2019	2020 onwards	Total
Bank loans <sup>1</sup>	Ps 1,585	Ps 5,473	Ps 3,138	Ps 6,279	Ps 16,475
Senior Notes <sup>2</sup>	-	-	-	10,123	10,123
Other loans	13	8	15	67	102
Financial lease	30	29	29	115	203
	Ps 1,628	Ps 5,510	Ps 2,449	Ps 16,585	Ps 26,903

<sup>1</sup> Interest on bank loans will be paid quarterly.

<sup>2</sup> Interest on Senior Notes will be paid semiannually.

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### **Covenants:**

Most existing bank debt agreements contain restrictions for the Company, primarily with respect to compliance with certain financial ratios, including:

- a. Interest coverage ratio: which is defined as profit before financial result, income taxes, depreciation and amortization (EBITDA<sup>1</sup>) for the period of the last four complete quarters divided by financial expenses, net, for the last four quarters, which shall not be less than 3.0 times.
- b. Leveraging ratio, defined at any point of its determination, as a result of dividing the consolidated net debt at said date by the consolidated EBITDA<sup>1</sup> for the preceding four quarters.

<sup>(1)</sup> As defined in Note 27.

Additionally to the aforementioned agreements, there are commitments related to the Senior Notes issued in February 2013, among the most important of which is the limitation to contract debt or increase it in the event that it does not comply with the fixed-charges coverage ratio at a rate of at least 2.25 times.

During 2016 and 2015, the financial ratios mentioned above were calculated in accordance with the formulas established in the effective debt agreements.

At December 31, 2016 and the date of issuance of these financial statements, the Company is in compliance with all obligations and covenants contained in its credit agreements; such obligations, among other conditions are subject to certain exceptions, and require or limit the ability of the Company to:

- Provide certain financial information.
- Maintain books and records.
- Maintain assets in appropriate conditions.
- Comply with applicable laws, rules and regulations applicable.
- Incur additional indebtedness.
- Pay dividends (only applicable to Nemak, SAB).
- Grant liens on assets.
- Enter into transactions with affiliates.
- Perform a consolidation, merger or sale of assets, and
- Carry out sale and lease-back operations

As of December 31, 2016 and 2015 there are no assets pledged as collateral for any of the subsidiaries, except for:

1. Some assets, pledged as collateral in a long-term debt granted by a Brazilian government entity to promote investment ("BNDES"). At December 31, 2016 the outstanding balance and the value of the pledged assets are approximately US\$ 6.1 (Ps 125.3) and US\$3.9 (Ps67.1), respectively.
2. Various minor loans to finance equipment acquisitions in several subsidiaries with liens accumulated by approximately US\$0.6 (Ps11.8).

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#### **Significant debt transactions in 2016:**

- a. New financing. During December 2016, the Company completed its refinancing of the debt of its subsidiary, Nemak Izmir (a business acquired, see Note 2) through Unicredit Bank A. G. The loan was of EUR34 at a term of a little over 3 years and payable in a single installment on the final maturity date. The applicable interest rate is variable at Euribor+1.6%. The loan is unsecured.
- b. Increase in revolving lines committed in the medium term. Nemak contracted US\$20 with Comerica Bank and US\$50 with Scotia Bank, both at a three-year term and maturing in January and April 2019 respectively.

#### **Significant debt transactions in 2015:**

- a. A bank facility amounting to US\$300 (Ps5,162) with a group of banks (BBVA Bancomer as agent bank) with a final maturity of 5 years and average life of 3.6 years. Interests will be payable quarterly at a variable interest rate of Libor+1.25% (effective interest rate 2.1%). Proceeds of this loan were used to prepay all of the unsecured Peso Bond "Nemak -07" by Ps3,500 that would expire at the end of 2017.
- b. Financing amounting to US\$200 (Ps3,441), with two banks (Bancomext and Nacional Financiera) with a total term of 10 years and average life of 7.9 years. Interests will be payables quarterly at a variable interest rate of Libor+2.8% (effective interest rate 3.5%). Resources were used to prepay substantially all short-term debt of the Company.
- c. The company increased its midterm committed credit lines in US\$110, from US\$192 (Ps3,304) at end of 2014 to US \$ 302 (Ps5,196) at the end of 2015. The total amount of these revolving committed lines matures during December 2018. At December 31, 2016, the committed credit lines were totally available.

The financial lease liabilities are effectively protected as the rights to the leased asset revert to the lessor in the event of default.

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Obligation for financial leases - minimal payments, gross:		
- Less than 1 year	Ps 30	Ps 70
- More than 1 year and less than 5 years	148	103
- More than 5 years	96	99
Future finance charges on financial lease liabilities	<u>(71)</u>	<u>(75)</u>
Present value of liabilities from financial lease	<u>Ps 203</u>	<u>Ps 197</u>

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The present value of finance lease liabilities is analyzed as follows:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Less than 1 year	Ps 17	Ps 29
More than 1 year and less than 5 years	101	72
More than 5 years	<u>85</u>	<u>96</u>
	<u>Ps 203</u>	<u>Ps 197</u>

#### **Note 16 - Deferred taxes:**

The analysis of the deferred tax asset and deferred tax liability is as follows:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Deferred tax asset:		
- To be recovered in more than 12 months	Ps 1,000	Ps 840
- To be recovered within 12 months	<u>520</u>	<u>481</u>
	1,520	1,321
Deferred tax liability:		
- To be covered in more than 12 months	(4,732)	(2,852)
- To be covered within 12 months	<u>580</u>	<u>86</u>
	<u>(4,152)</u>	<u>(2,765)</u>
Deferred tax liabilities, net	<u>(Ps 2,632)</u>	<u>(Ps 1,444)</u>

The gross movement in the deferred income tax liabilities account is as follows:

	<u>2016</u>	<u>2015</u>
At January 1	(Ps 1,444)	(Ps 783)
Exchange differences	(412)	(115)
Charge to income statement	(766)	(659)
Tax related to components of other comprehensive income	<u>(10)</u>	<u>113</u>
At December 31	<u>(Ps 2,632)</u>	<u>(Ps 1,444)</u>

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**At December 31, 2016 and 2015**

The analysis of the deferred income tax assets and liabilities was as follows:

	<u>Assets (liabilities)</u>	
	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Inventories	Ps 9	Ps 36
Intangible assets	59	52
Reserve for valuation of assets	8	9
Valuation of derivative financial instruments	34	35
Liability provisions	567	483
Tax loss carryforwards	1,538	1,531
Other temporary differences - Net	<u>561</u>	<u>574</u>
Deferred tax asset	<u>2,776</u>	<u>2,720</u>
Property, plant and equipment	(3,870)	(3,423)
Intangible assets	(1,464)	(804)
Cost of debt issuance	(64)	(68)
Reserve for valuation of assets	(10)	(2)
Other temporary differences, net	<u>-</u>	<u>133</u>
Deferred tax liabilities	<u>(5,408)</u>	<u>(4,164)</u>
Deferred tax liabilities, net	<u>(Ps 2,632)</u>	<u>(Ps 1,444)</u>

Changes in the temporary differences during the year are shown below:

	<u>Balance at</u> <u>December 31,</u> <u>2015</u>	<u>(Charged)</u> <u>credited</u> <u>to the income</u> <u>statement</u>	<u>(Charged)</u> <u>credited to the</u> <u>comprehensive</u> <u>income</u>	<u>Balance at</u> <u>December 31,</u> <u>2016</u>
Inventories	Ps 36	(Ps 27)	Ps -	Ps 9
Intangible assets	52	7	-	59
Reserve for valuation of assets	9	(1)	-	8
Valuation of derivative financial instruments	35	9	(10)	34
Liability provisions	483	84	-	567
Tax loss carryforwards	1,531	7	-	1,538
Other temporary differences, net	<u>574</u>	<u>(13)</u>	<u>-</u>	<u>561</u>
Deferred tax asset	<u>2,720</u>	<u>66</u>	<u>(10)</u>	<u>2,776</u>
Property, plant and equipment	(3,423)	(447)	-	(3,870)
Intangible assets	(804)	(660)	-	(1,464)
Cost of debt issuance	(68)	4	-	(64)
Reserve for valuation of assets	(2)	(8)	-	(10)
Other temporary differences, net	<u>133</u>	<u>(133)</u>	<u>-</u>	<u>-</u>
Deferred tax liabilities	<u>(4,164)</u>	<u>(1,244)</u>	<u>-</u>	<u>(5,408)</u>
Deferred tax liabilities, net	<u>(Ps 1,444)</u>	<u>(Ps 1,178)</u>	<u>(Ps 10)</u>	<u>(Ps 2,632)</u>

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	Balance at December 31, 2014	(Charged) credited to the income statement	(Charged) credited to the comprehensive income	Balance at December 31, 2015
Inventories	Ps 26	Ps 10	Ps -	Ps 36
Intangible assets	56	(4)	-	52
Reserve for valuation of assets	17	(8)	-	9
Valuation of derivative financial instruments	230	(82)	(113)	35
Liability provisions	863	(380)	-	483
Tax loss carryforwards	1,366	165	-	1,531
Other temporary differences, net	<u>207</u>	<u>368</u>	<u>-</u>	<u>574</u>
Deferred tax asset	<u>2,764</u>	<u>69</u>	<u>(113)</u>	<u>2,720</u>
Property, plant and equipment	(2,927)	(496)	-	(3,423)
Intangible assets	(602)	(202)	-	(804)
Cost of debt issuance	(59)	(9)	-	(68)
Reserve for valuation of assets	(3)	1	-	(2)
Other temporary differences, net	<u>44</u>	<u>89</u>	<u>-</u>	<u>133</u>
Deferred tax liabilities	(Ps3,547)	(Ps 617)	Ps -	(Ps 4,164)
Deferred tax liabilities, net	<u>(Ps 783)</u>	<u>(Ps 548)</u>	<u>(Ps 113)</u>	<u>(Ps 1,444)</u>

Deferred income tax asset is recorded as tax loss carryforwards when the realization of the related tax benefits through future taxable profits is probable.

Tax losses at December 31, 2016 expire in the following years:

<u>Year of maturity</u>	<u>Amount</u>
2017	Ps 398
2018	20
2019	62
2020	87
2021	102
2022	565
2023	554
2024 and onwards	3,135
No expiration date	<u>25</u>
	<u>Ps5,128</u>

#### Optional regime for company groups in Mexico (Incorporation Regime)

Derived from the elimination of tax consolidation in Mexico, Nemak SAB and its Mexican subsidiaries chose to join the optional Regime for groups of companies from 2014.

In general terms, the Regime is to group companies that have the option of deferring a portion of its corporate income tax (ISR) payments, which becomes due in three years. The deferral percentage is calculated by a factor that is determined by the amount of tax profit and losses that have obtained the Group companies during the fiscal year.

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To be taxed under this system, the integrative legal entity, which holds one or more companies, must hold directly or indirectly 80% or more of the shares with voting rights of one or more of the legal entities called integrated.

In June 2015 as a result of the IPO, Nemak SAB and its Mexican subsidiaries ceased to be considered as integrated companies.

In terms of the Income Tax Law, a company that ceases to be integrated must disincorporate of this Regime on the date of the assumption occurs and pays within one month the amount of the deferred income tax.

The effects of the divestiture of the incorporation Regime in 2015 were as follows:

**a. Income tax prepayments 2015**

Considering that at the date of the divestitures referred to in this report, there were no guidelines in the Income Tax Law to establish how companies should pay the deferred Income tax prepayments, Nemak SAB and its Mexican subsidiaries paid the deferred payment of accumulated and historical in July 2015; the payment made was Ps97.

Deferred income tax from January to June was paid together with the July ISR prepayments, on August 17, 2015.

**Note 17 - Other liabilities:**

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
<u>Current:</u>		
Other taxes and withholdings	Ps 371	Ps 670
Deferred income <sup>1</sup>	-	51
Employees' profit sharing payable	139	138
Share-based employee benefits (Note 20)	31	54
Bank overdrafts	-	1
Other	-	79
Total other liabilities	<u>Ps 541</u>	<u>Ps 993</u>
<u>Non-current:</u>		
Other	<u>Ps 618</u>	<u>Ps 6</u>
Total	<u>Ps 618</u>	<u>Ps 6</u>

<sup>1</sup> At December 31, 2015, it includes Ps51 current deferred income, received from the cancellation of energy supply contracts from the supplier.

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#### **Note 18 - Employee benefits:**

The valuation of employee benefits for retirement plans covers approximately 83% of workers in 2016 and 82% in 2015, and is based primarily on their years of service, current age and estimated salary at retirement date.

The principal subsidiaries of the Company have established funds for the payment of retirement benefits through irrevocable trusts.

The employee benefit obligations recognized in the statement of financial position, by country, are shown below:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Mexico	Ps 323	Ps 247
United States	42	39
Canada	151	114
Poland	122	81
Austria	246	191
Germany	99	72
Others	<u>75</u>	<u>35</u>
Total	<u>Ps 1,058</u>	<u>Ps 779</u>

Following is a summary of the main financial information of such employee benefits:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Liabilities in the balance sheet for:		
Pension benefits	Ps 897	Ps 662
Post-employment medical benefits	<u>161</u>	<u>117</u>
Liabilities in the balance sheet	<u>1,058</u>	<u>779</u>
Charge in the income statements for:		
Pension benefits	(186)	(124)
Post-employment medical benefits	<u>(9)</u>	<u>(7)</u>
	<u>(195)</u>	<u>(131)</u>
Remeasurements recognized in the statement of other comprehensive income for the period		
Pension benefits	(Ps 61)	(Ps 18)
Post-employment medical benefits	<u>(12)</u>	<u>6</u>
	<u>(73)</u>	<u>(12)</u>
Cumulative remeasurements recognized in other comprehensive income	<u>(Ps 186)</u>	<u>(Ps 113)</u>

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### **Pension benefits**

The Company operates defined benefit pension plans based on employees' pensionable remuneration and length of service. Most plans are externally funded. Plan assets are held in trusts, foundations or similar entities, governed by local regulations and practice in each country, as is the nature of the relationship between the Company and the respective trustees (or equivalent).

Amounts recognized in the balance sheet are determined as follows:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Present value of defined benefit obligations	Ps 1,504	Ps 1,154
Fair value of plan assets	<u>(607)</u>	<u>(492)</u>
Liabilities in balance sheet	<u>Ps 897</u>	<u>Ps 662</u>

The movement in the defined benefit obligation during the year was as follows:

	<u>2016</u>	<u>2015</u>
At January 1	Ps 1,154	Ps 1,041
Current service cost	127	79
Interest cost	47	39
Employee contributions	1	1
Remeasurements:		
Financial actuarial losses/(gains)	58	14
Benefits paid	(34)	(55)
Exchange differences	<u>151</u>	<u>35</u>
At December 31	<u>Ps 1,504</u>	<u>Ps 1,154</u>

The movement in the fair value of plan assets for the year was as follows:

	<u>2016</u>	<u>2015</u>
At January 1	(Ps 492)	(Ps 475)
Interest Income	(11)	(14)
Remeasurements - expected return on plan assets, excluding interest income	3	4
Exchange differences	(92)	(14)
Employer contributions	(16)	(13)
Employee contributions	(1)	(1)
Benefits paid	<u>2</u>	<u>21</u>
At December 31	<u>(Ps 607)</u>	<u>(Ps 492)</u>

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Amounts recorded in the statement of income are as follows:

	<u>2016</u>	<u>2015</u>
Current service cost	(Ps 127)	(Ps 79)
Financial costs, net	(36)	(25)
Effect from reduction or settlement	<u>(23)</u>	<u>(20)</u>
Total included in personal costs	<u>(Ps 186)</u>	<u>(Ps 124)</u>

The principal ranges of actuarial assumptions were as follows:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Mexico:		
Inflation rate	3.50%	4.25%
Salary increase rate	4.50%	5.25%
Future salary increase	3.50%	4.25%
Medical inflation rate	6.50%	7.50%
Discount rate:		
Mexico	7.75%	6.75%
Canada	3.99%	3.99%
Austria	2.00%	2.00%

The average life of defined benefit obligations is of 18 and 18 years at December 31, 2016 and 2015, respectively.

The sensitivity analysis of the main assumptions for defined benefit obligations were as follows:

	<u>Effect in defined benefit obligations</u>		
	<u>Change in assumptions</u>	<u>Increase in assumptions</u>	<u>Decrease in assumptions</u>
Discount rates	1.0%	Decreases by Ps17	Increases by Ps20

### Post-employment medical benefits

The Company operates post-employment medical benefits schemes mainly in Mexico and Canada. The method of accounting, assumptions and the frequency of valuations are similar to those used for defined benefit pension schemes. Most of these plans are not being funded.

Amounts recognized in the balance sheet are determined as follows:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Present value of obligations equal to liabilities in balance sheet	<u>Ps 161</u>	<u>Ps 117</u>

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The movements of defined benefit obligations are as follows:

	<u>2016</u>	<u>2015</u>
At January 1	Ps 117	Ps 124
Current service cost	4	3
Interest cost	5	4
Financial actuarial losses/(gains)	12	(10)
Employee contributions	4	-
Exchange differences	31	(2)
Benefits paid	<u>(8)</u>	<u>(2)</u>
At December 31	<u>Ps 161</u>	<u>Ps 117</u>

Amounts recorded in the statement of income are as follows:

	<u>2016</u>	<u>2015</u>
Current service cost	(Ps 4)	(Ps 3)
Interest cost	<u>(5)</u>	<u>(4)</u>
Total included in personal costs	<u>(Ps 9)</u>	<u>(Ps 7)</u>

#### **Note 19 - Equity:**

At December 31, 2016 and 2015, the nominal capital stock, subscribed and paid-in of Ps6,607, was represented by 3,081 million of common, nominative shares, "Class I" of Series "A", with no par value, entirely subscribed and paid.

At December 31, 2016 and 2015, the shares was represented as follows:

<u>Shareholder</u>	<u>Number of shares (in millions)</u>	<u>Amount</u>
ALFA	2,318	Ps 4,971
FORD	168	360
Public float	<u>595</u>	<u>1,276</u>
	<u>3,081</u>	<u>Ps 6,607</u>

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The movement in the capital stock during the year, are detailed as follow:

	<u>Note</u>	<u>Capital stock</u>	<u>Share premium</u>
Balance as of January 1, 2015		Ps 874	Ps -
Increase of capital stock	2b	14,196	-
Merger with GIALFA	2c	55	-
Capital distribution	2d	(9,544)	-
Initial Public Offering		1,026	10,871
IPO Issuance costs	2e	-	(428)
Movement of the year		<u>5,733</u>	<u>10,443</u>
Balance as of December 31, 2015		Ps 6,607	Ps10,443
IPO Issuance costs		-	(9)
Movement of the year		-	(9)
Balance as of December 31, 2016		<u>Ps 6,607</u>	<u>Ps10,434</u>

The movement in outstanding shares for the year was as follows:

	<u>Note</u>	<u>Number of shares (in millions)</u>
Shares at January 1, 2015		871
Split effect <sup>1</sup>		<u>1,616</u>
Result of the share split		2,486
Shares issued in IPO	2e	538
Shares issued in overallotment	2e	<u>57</u>
Shares at December 31, 2015 and 2016		<u>3,081</u>

At December 31, 2015, the weighted average of shares outstanding was 2,781.

During the year 2016, there were no movements in outstanding shares

<sup>1</sup> In an Ordinary and Extraordinary shareholders meeting on June 15, 2015, a share split at a ratio of approximately 2.8561 Shares for every existing share (the "Share Split") was approved. Due to the above, the split effects were considered retrospectively in the weighted average of outstanding shares from 2014.

The profit for the period is subject to the legal provision requiring at least 5% of the profit for each period to be set aside to increase the legal reserve until it reaches an amount equivalent to 20% of the capital stock. At December 31, 2016 and 2015, the legal reserve amounted to Ps174, which is included in retained earnings.

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The dividends paid in 2016 and 2015 were Ps1,755 (Pso.59 per share) and Ps1,253 (Pso.48 per share), which fully arise from the Net Tax Profit Account(CUFIN).

Dividends paid are not subject to income tax if paid from the CUFIN. Any dividends paid in excess of this account will cause a tax equivalent to 42.86% if they are paid in 2017. This tax is payable by the Company and may be credited against its income tax in the same year or the following two years or, if applicable, against the flat tax of the period. Dividends paid from profits which have previously paid income tax are not subject to tax withholding or to any additional tax payment. At December 31, 2016, the tax value of the consolidated CUFIN and value of the Capital Contribution Account (CUCA) amounted to Ps6,040 and Ps9,294, respectively.

In October 2013 the Chamber of Senators and Deputies approved the issuance of a new Income Tax Law (LISR), which became effective on January 1, 2014. Among other aspects, this law establishes a tax of 10% for profits generated as from 2014 on dividends paid to foreign residents and Mexican individuals. It is also established that for fiscal years 2001 to 2013, the net tax profit will be determined under the LISR terms effective in the corresponding fiscal year. In November 2015, an article of temporary duration by which a fiscal incentive is given to individuals residing in Mexico that are subject to additional payment of 10% on dividends or profits distributed are issued.

The incentive is applicable provided that such dividends or profits were generated in 2014, 2015, 2016 and are reinvested in the legal entity that generated such profits, and consists of a tax credit equal to the amount obtained by applying the dividend or utility is distributed, which corresponds to year percentage distribution as follows:

Year of distribution of dividend or profit	Percentage of application to the amount of dividend or profit distributed
2017	1%
2018	2%
2019 onwards	5%

The tax credit only will be used against additional 10% income tax that the entity must withhold and pay.

To apply the tax credit, must meet the following requirements:

- The entity must identify in its accounts the corresponding accounting records to earnings or dividends generated in 2014, 2015 and 2016 records and the respective distributions.
- Present in the notes to the financial statements analytical information for the period in which profits were generated, dividends were reinvested or distributed.
- For corporations whose shares are not traded on the Mexican Stock Exchange and implement this incentive should choose to audit their financial statements for tax purposes in terms of Article 32-A of the Tax Code of the Federation.

Entities distributing dividends or profits in respect of shares placed among the investing public should inform brokerage firms, credit institutions, investment operators, the people who carry out the distribution of shares of investment companies, or any other intermediary market, the exercises from which the dividends so that these brokers carry the corresponding withholding. For the year ended at 31 December 2016, the company generated profit of Ps5,410 (Ps4,599 in 2015) which may be subject to this incentive.

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In the case of a capital reduction, the procedures established by the Income Tax Law establishes to give to any excess of stockholders' equity over the capital contributions, the same tax treatment as applicable to dividends.

The movements in cumulative other comprehensive income for 2016 and 2015 are presented below:

	Effect of cash flow hedge derivatives instruments	Effect from foreign currency translation	Total
At January 1, 2015	(Ps 81)	Ps 1,182	Ps 1,101
Losses on fair value	(248)	-	(248)
Gains on translation of foreign entities	<u>-</u>	<u>1,391</u>	<u>1,391</u>
At December 31, 2015	(329)	2,573	2,244
Losses on fair value	(9)	-	(9)
Gains on translation of foreign entities	<u>-</u>	<u>5,486</u>	<u>5,486</u>
At December 31, 2016	<u>(Ps 338)</u>	<u>Ps 8,059</u>	<u>Ps 7,721</u>

#### **Foreign currency translation**

The foreign exchange differences arising from the translation of financial statements of foreign subsidiaries are recorded.

#### **Effect of derivative financial instruments**

At December 31, 2016 and 2015, the effect of derivative financial instruments contracted as cash-flow hedging represents the early cancellation of a gas hedging operation conducted by the Company in December 2015. Said accumulated effect is shown in other comprehensive income for Ps283 and Ps329 at December 31, 2016 and 2015, respectively. Said amounts will be reclassified to the statement of income as the predicted transactions is carried out, as set out in Note 4.1 d.

#### **Note 20 - Share based payments:**

The Company has a compensation scheme referenced to the value of ALFA's shares for senior executives of ALFA and its subsidiaries. According to the terms of the plan, eligible executives will receive a cash payment conditional on the achievement of certain quantitative and qualitative metrics based on the following financial measures:

- Improved share price
- Improvement in net income
- Permanence of the executives in the Company

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The program consists of determining a number of shares on which the executives shall be based. The bonus will be paid in cash over the next five years, i.e. 20% each year at the average price per share in pesos at the end of each year. The average price of the share in Mexican Pesos in 2016 and 2015 was Ps26.73 and Ps34.30, respectively.

The short-term and long-term liability was analyzed as follows:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Short-term	Ps 11	Ps 18
Long-term	<u>20</u>	<u>36</u>
Total carrying value	<u>Ps 31</u>	<u>Ps 54</u>

#### **Note 21 - Expenses classified by their nature:**

The total cost of sales and selling and administrative expenses, classified by the nature of the expense, were as follows:

	<u>2016</u>	<u>2015</u>
Raw materials	(Ps 31,815)	(Ps 29,520)
Maquila (production outsourcing)	(6,537)	(6,019)
Employee benefit expenses (Note 24)	(12,181)	(10,194)
Personnel expenses	(2,048)	(1,920)
Maintenance	(4,094)	(3,659)
Depreciation and amortization	(5,873)	(4,609)
Freight charges	(868)	(871)
Advertising expenses	(21)	(16)
Consumption of energy and fuel	(2,905)	(2,554)
Travel expenses	(324)	(281)
Operating leases	(411)	(362)
Technical assistance, professional fees and administrative services	(675)	(1,397)
Other	<u>(2,550)</u>	<u>(2,134)</u>
Total	<u>(Ps 70,302)</u>	<u>(Ps 63,536)</u>

#### **Note 22 - Other (expenses) income - Net:**

	<u>2016</u>	<u>2015</u>
Loss on sale of property, plant and equipment	(Ps 4)	(Ps 12)
Impairment of property, plant and equipment	(293)	-
Customer reimbursements	-	9
Other	<u>39</u>	<u>46</u>
Total other (expenses) income - Net	<u>(Ps 258)</u>	<u>Ps 43</u>

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### **Note 23 - Financial result, net:**

	<u>2016</u>	<u>2015</u>
Financial income:		
- Interest income in short term bank deposits	Ps 8	Ps 8
- Intercompany financial income	34	24
- Other financial income <sup>1</sup>	<u>11</u>	<u>13</u>
Total financial income, excluding foreign exchange gain	53	45
Foreign exchange gain	<u>14,604</u>	<u>6,200</u>
Total financial income	<u>Ps14,657</u>	<u>Ps6,245</u>
Financial expenses:		
- Interest expense on bank loans	(Ps 1,235)	(Ps1,097)
- Intercompany financial costs	-	-
- Other financial costs <sup>2</sup>	<u>(22)</u>	<u>(75)</u>
Total financial costs, excluding foreign exchange loss	(1,257)	(1,172)
Foreign exchange loss	<u>(14,839)</u>	<u>(6,366)</u>
Financial expense	<u>(16,096)</u>	<u>(7,538)</u>
Financial result, net	<u>(Ps 1,439)</u>	<u>(Ps1,293)</u>

<sup>1</sup> Includes mainly the yield on plan assets and other concepts.

<sup>2</sup> Includes mainly the financial costs of employee benefits.

### **Note 24 - Employee benefit expenses:**

	<u>2016</u>	<u>2015</u>
Salaries, wages and benefits	Ps 9,890	Ps 8,360
Contributions to social security	1,817	1,435
Employee benefits (Note 18)	155	103
Other contributions	<u>319</u>	<u>296</u>
Total	<u>Ps 12,181</u>	<u>Ps10,194</u>

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## **Note 25 - Income tax for the year:**

	<u>2016</u>	<u>2015</u>
Tax currently payable:		
Income tax on profits of the period	(Ps1,114)	(Ps 871)
Adjustment for previous years	<u>(10)</u>	<u>(21)</u>
Total tax currently payable	<u>(1,124)</u>	<u>(893)</u>
Deferred tax:		
Origination and reversal of temporary differences	<u>(766)</u>	<u>(659)</u>
Total deferred tax	<u>(766)</u>	<u>(659)</u>
Income taxes charged to income	<u>(Ps1,890)</u>	<u>(Ps 1,552)</u>

The reconciliation between the statutory and effective rates of income tax was as follows:

	<u>2016</u>	<u>2015</u>
Profit before taxes	Ps7,300	Ps 6,153
Share of gain of associates recognized through equity method	<u>(55)</u>	<u>(48)</u>
Income before equity in associates	7,245	6,105
Statutory rate	<u>30%</u>	<u>30%</u>
Tax at statutory rate	(2,173)	(1,831)
(Add) deduct tax effect of:		
Difference based on the comprehensive financial result	(188)	(120)
Non-deductible	150	12
Non taxable exchange rate effects	295	287
Other permanent differences, net	<u>27</u>	<u>100</u>
Total provision for income taxes charged to income	<u>(Ps1,890)</u>	<u>(Ps 1,552)</u>
Effective rate	<u>26%</u>	<u>25%</u>

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The tax charge/(credit) relating to components of other comprehensive income was as follows:

	2016			2015		
	Before taxes	Tax payable/ (receivable)	After taxes	Before taxes	Tax payable/ (receivable)	After taxes
Translation effect of foreign entities	Ps 5,486	Ps -	Ps 5,486	Ps 1,390	Ps -	Ps 1,390
Remeasurement of obligations for employee benefits	(73)	18	(55)	(11)	1	(10)
Effect of derivative financial instruments hired as cash flow hedges	74	(28)	46	(359)	111	(248)
Other items of comprehensive income	<u>Ps 5,487</u>	<u>(Ps 10)</u>	<u>Ps 5,477</u>	<u>Ps 1,020</u>	<u>Ps 112</u>	<u>Ps 1,132</u>
Deferred taxes		<u>(Ps 10)</u>			<u>Ps 112</u>	

### **Note 26 - Related party transactions:**

Transactions with related parties during the years ended December 31, 2016 and 2015, which were carried out in terms similar to those of arm's-length transactions with independent third parties, were as follows:

December 31, 2016							
Loans granted to related parties							
	Accounts receivable	Amount	Interest	Currency	Maturity date DD/MM/YY	Interest rate	Accounts payable
Parent	Ps -	Ps 720	Ps 69	MXP	18/08/2018	4.42%	Ps -
Affiliates	8	-	-				54
Associates	-	-	43	EUR	04/08/2018	6.00%	-
Ford	<u>2,260</u>	-	-				-
Total	<u>Ps 2,268</u>	<u>Ps 720</u>	<u>Ps 112</u>				<u>Ps 54</u>
December 31, 2015							
Loans granted to related parties							
	Accounts receivable	Amount	Interest	Currency	Maturity date DD/MM/YY	Interest rate	Accounts payable
Parent	Ps -	Ps 655	Ps 9	USD	01/01/2016	4.42%	Ps -
Affiliates	8	-	-				50
Associates	-	-	34	EUR	04/08/2015	6.00%	-
Ford	<u>2,701</u>	-	-				-
Total	<u>Ps 2,709</u>	<u>Ps 655</u>	<u>Ps 43</u>				<u>Ps 50</u>

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Sales revenues and other related parties:

	<u>Year ended December 31, 2016</u>			
	<u>Finished goods</u>	<u>Interest</u>	<u>Dividends</u>	<u>Others</u>
Parent	Ps -	Ps 32	Ps -	Ps -
Ford	24,380	-	-	-
Associates	-	-	-	198
Total	<u>Ps24,380</u>	<u>Ps 32</u>	<u>Ps -</u>	<u>Ps198</u>

	<u>Year ended December 31, 2015</u>			
	<u>Finished goods</u>	<u>Interest</u>	<u>Dividends</u>	<u>Others</u>
Parent	Ps -	Ps 24	Ps -	Ps -
Ford	23,540	-	-	-
Associates	-	-	17	217
Total	<u>Ps23,540</u>	<u>Ps 24</u>	<u>Ps17</u>	<u>Ps217</u>

Cost of sales and other expenses with related parties

	<u>Year ended December 31, 2016</u>		
	<u>Administrative services</u>	<u>Other cost and expenses</u>	<u>Dividends paid</u>
Parent	Ps -	Ps -	Ps1,321
Affiliates	73	194	-
Associates	-	196	-
Ford	-	-	95
Total	<u>Ps73</u>	<u>Ps390</u>	<u>Ps1,416</u>

	<u>Year ended December 31, 2015</u>		
	<u>Administrative services</u>	<u>Other cost and expenses</u>	<u>Dividends paid</u>
Parent	Ps -	Ps -	Ps 1,112
Affiliates	87	225	-
Associates	-	215	-
Ford	-	-	80
Total	<u>Ps 87</u>	<u>Ps440</u>	<u>Ps 1,192</u>

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The Company has declared they have no significant transactions with related parties or conflicts of interest to disclose.

At December 31 2016 and 2015, the Company has recognized intangible assets related with Ford by Ps1,325 and Ps608, respectively. See Note 12.

For the years ended December 31, 2016 and 2015, wages and benefits received by top officials of the Company were Ps131 and Ps200, respectively, an amount comprising base salary, social benefits and supplemented mainly by a variable compensation program governed by the results of the Company and by the average price of the Alfa's shares.

#### **Note 27 - Financial information by segments:**

The Company manages and assesses its ongoing operations considering the group as a whole, however, the operating segments are reported based on the financial information presented before the Chief Operating Decision Maker (CODM) of the Company. The CODM who is responsible for assigning resources and assessing the performance of operating segments, has been identified as the Chief Executive Officer of the Company (CEO). The CODM considers the business from a geographical perspective.

The CODM analyzes the business segments of the Company by grouping operating segments (normally plants operating in the common geographical area), defined as two segments subject to reporting, separately.

Firstly North America; in which Mexican, Canadian and United States operations are grouped. Europe operations include the plants in Germany, Spain, Hungary, Czech Republic, Austria, Poland, Slovakia, Russia and Turkey.

The operating segments that fail to comply with the limit established by the standard itself to be reported separately, such as Asia (including plants in China and India), South America (including plants in Brazil and Argentina), and other less significant operations, are added and shown under the "rest of the world".

Transactions between operating segments are performed at market value, and the accounting policies for which the financial information by segments is prepared, are consistent with those described in Note 3s.

The Company assesses the performance of each one of the operating segments based primarily on income before the financial result, taxes, depreciation, amortization and the impairment in non-current assets (Adjusted UAFIDA or EBITDA), considering that such indicator represents a good measure to assess the operating performance and the capacity to satisfy principal and interest obligations in respect to indebtedness, as well as the capacity to fund capital investments and working capital requirements. However, adjusted UAFIDA or EBITDA is not a financial performance measure under IFRS, and should not be considered as an alternative to net profit as an operating performance measure, or cash flow as a liquidity measure.

The Company has defined adjusted UAFIDA or EBITDA as consolidated profit (loss) before tax after adding back or subtracting, as the case may be: (1) depreciation and amortization, and impairment of non-current assets (2) non-current assets write-down, (3) financial result, net (which includes interest expense, interest income, foreign exchange gains (losses), net and gain (loss) of derivative financial instruments), (4) share of gain of associates and (5) exceptional items.

# ***Nemak, S. A. B. de C. V. and subsidiaries***

(subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

For the year ended December 31, 2016

	<u>North America</u>	<u>Europe</u>	<u>Rest of the world</u>	<u>Eliminations</u>	<u>Total</u>
Income statement					
Sales by segment	Ps 46,793	Ps 26,816	Ps 6,707	(Ps 1,072)	Ps 79,244
Inter-segment sales	<u>(695)</u>	<u>(328)</u>	<u>(49)</u>	<u>1,072</u>	<u>-</u>
Sales from external customers	<u>46,098</u>	<u>26,488</u>	<u>6,658</u>	<u>-</u>	<u>79,244</u>
EBITDA					
Operating profit	5,882	2,776	26	-	8,684
Depreciation and amortization	3,682	1,610	581	-	5,873
Non-current assets write-down	<u>289</u>	<u>3</u>	<u>-</u>	<u>-</u>	<u>292</u>
Adjusted EBITDA	<u>9,853</u>	<u>4,389</u>	<u>607</u>	<u>-</u>	<u>14,849</u>
Capital expenditures (CAPEX)	<u>Ps 4,919</u>	<u>Ps 4,321</u>	<u>Ps 924</u>	<u>Ps -</u>	<u>Ps 10,164</u>

For the year ended December 31, 2015

	<u>North America</u>	<u>Europe</u>	<u>Rest of the world</u>	<u>Eliminations</u>	<u>Total</u>
Income statement					
Sales by segment	Ps 44,202	Ps 22,023	Ps 5,502	(Ps 837)	Ps 70,891
Inter-segment sales	<u>(643)</u>	<u>(194)</u>	<u>-</u>	<u>837</u>	<u>-</u>
Sales from external customers	<u>43,559</u>	<u>21,829</u>	<u>5,502</u>	<u>-</u>	<u>70,891</u>
EBITDA					
Operating profit	5,389	2,100	(91)	-	7,398
Depreciation and amortization	3,009	1,191	409	-	4,609
Non-current assets write-down	<u>-</u>	<u>(4)</u>	<u>3</u>	<u>-</u>	<u>(1)</u>
Adjusted EBITDA	<u>8,398</u>	<u>3,287</u>	<u>321</u>	<u>-</u>	<u>12,006</u>
Capital expenditures (CAPEX)	<u>Ps 3,426</u>	<u>Ps 2,658</u>	<u>Ps 1,169</u>	<u>Ps -</u>	<u>Ps 7,253</u>

The reconciliation between "Adjusted EBITDA" and profit before tax is as follows:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Adjusted EBITDA	Ps 14,849	Ps 12,006
Depreciation and amortization	(5,873)	(4,609)
Non-current assets write-down	<u>(292)</u>	<u>1</u>
Operating profit	8,684	7,398
Financial result	(1,439)	(1,293)
Share of gain of associates	<u>55</u>	<u>48</u>
Profit before tax	<u>Ps 7,300</u>	<u>Ps 6,153</u>

## ***Nemak, S. A. B. de C. V. and subsidiaries***

(subsidiary of Alfa, S. A. B. de C. V.)

### Notes to the Consolidated Financial Statements

At December 31, 2016 and 2015

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For the year ended December 31, 2016

	<u>Property plant and equipment</u>	<u>Goodwill</u>	<u>Intangible assets</u>
North America	Ps 27,582	Ps 2,455	Ps 3,116
Europe	16,929	3,629	1,967
Rest of the world	<u>5,583</u>	<u>-</u>	<u>890</u>
Total	<u>Ps 50,094</u>	<u>Ps 6,084</u>	<u>Ps 5,973</u>

For the year ended December 31, 2015

	<u>Property plant and equipment</u>	<u>Goodwill</u>	<u>Intangible assets</u>
North America	Ps 22,909	Ps 2,073	Ps 1,553
Europe	11,117	3,114	828
Rest of the world	<u>4,237</u>	<u>-</u>	<u>464</u>
Total	<u>Ps 38,263</u>	<u>Ps 5,187</u>	<u>Ps 2,845</u>

Nemak's clients are automotive companies, known as OEMs. The Company has the following global clients whose transactions represent more than 10% of the consolidated sales: Ford 29% and 34%, General Motors 28% and 26% and Fiat-Chrysler 11% and 13%, in 2016 and 2015, respectively.

#### **Note 28 - Commitments and contingencies:**

At December 31, 2016 and 2015, the Company had the following contingencies:

- In the normal course of its business, the Company is involved in disputes and litigation. While the results of the disputes cannot be predicted, the Company does not believe that there are current or threatened actions, claims or legal proceedings against or affecting the Company which, if determined adversely to it, would have a material adverse effect on its results of operations or financial position.
- The Company has certain legal disputes with the Brazilian tax authorities. The main dispute is related to the application of certain criteria and other minor contingencies related to labor and social security issues. In this process, the company made deposits by the amounts in dispute and is waiting for a final decision to their claims. The amounts mentioned above are Ps474 in 2016 and Ps323 in 2015.
- The Company leases various plant and machinery under non-cancellable operating lease agreements. The lease terms are between 5 and 10 years, and the majority of lease agreements are renewable at the end of the lease period at market rate.

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## **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

The future aggregate minimum lease payments under non-cancellable operating leases are as follows:

	<u>As of December 31,</u>	
	<u>2016</u>	<u>2015</u>
No later than 1 year	Ps 981	Ps 221
Later than 1 year and no later than 5 years	105	421
Later than 5 years	160	527

### **Note 29 - Foreign currency position:**

At February 17, 2017, the date of issuance of these financial statements, the exchange rate was 20.33 Mexican pesos per dollar.

The figures below are expressed in millions of dollars, since this is the prevailing foreign currency for Company.

At December 31, 2016 and 2015 had the following assets and liabilities in foreign currencies:

	<u>As of December 31, 2016</u>				
	<u>Dollars (USD)</u>		<u>Other currencies</u>		
	<u>USD</u>	<u>Mexican pesos</u>	<u>USD</u>	<u>Mexican Pesos</u>	<u>Total of Mexican Pesos</u>
Monetary assets	Ps 199	Ps 4,114	Ps 623	Ps 12,871	Ps 16,984
Monetary liabilities:					
Current	(110)	(2,275)	(821)	(16,961)	(19,235)
Non-current	<u>(959)</u>	<u>(19,811)</u>	<u>(475)</u>	<u>(9,808)</u>	<u>(29,619)</u>
Monetary position in foreign currencies	<u>(Ps 870)</u>	<u>(Ps 17,972)</u>	<u>(Ps 673)</u>	<u>(Ps 13,898)</u>	<u>(Ps 31,870)</u>

	<u>As of December 31, 2015</u>				
	<u>Dollars (USD)</u>		<u>Other currencies</u>		
	<u>USD</u>	<u>Mexican pesos</u>	<u>USD</u>	<u>Mexican Pesos</u>	<u>Total Mexican Pesos</u>
Monetary assets	Ps 210	Ps 3,621	Ps 617	Ps 10,612	Ps 14,233
Monetary liabilities:					
Current	(155)	(2,666)	(935)	(16,090)	(18,756)
Non-current	<u>(983)</u>	<u>(16,908)</u>	<u>(443)</u>	<u>(7,617)</u>	<u>(24,525)</u>
Monetary position in foreign currencies	<u>(Ps 928)</u>	<u>(Ps 15,953)</u>	<u>(Ps 761)</u>	<u>(Ps 13,095)</u>	<u>(Ps 29,048)</u>

## ***Nemak, S. A. B. de C. V. and subsidiaries***

(subsidiary of Alfa, S. A. B. de C. V.)

Notes to the Consolidated Financial Statements

At December 31, 2016 and 2015

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### **Note 30 - Subsequent events:**

In the preparation of the financial statements, the Company has assessed the events and transactions for their recognition or subsequent disclosure as of December 31, 2016 and up to February 17, 2017 (date of issuance of these financial statements) and it has concluded that there are no subsequent events affecting the financial statements.



Armando Tamez Martínez  
Chief Executive Officer



Alberto Sada Medina  
Chief Financial Officer