



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

**Third Quarter 2021 Earnings Webcast**

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## C O R P O R A T E P A R T I C I P A N T S

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## C O N F E R E N C E C A L L P A R T I C I P A N T S

**Marcelo Motta**, *JPMorgan*

**Alfonso Salazar**, *Scotiabank*

**Alejandro Azar**, *GBM*

**Abraham Fuentes**, *BlackRock*

**Andres Cardona**, *Citigroup*

## P R E S E N T A T I O N

### **Operator**

Good morning, everyone, and welcome to Nemak's Third Quarter 2021 Earnings Webcast.

Armando Tamez, Nemak's CEO, Alberto Sada, CFO, and Adrian Althoff, Investor Relations Officer, are here this morning to discuss the Company's business performance and answer any questions that you may have.

As a reminder, today's event is being recorded and will be available on the Company's Investor Relations website.

I would now like to turn this call over to Adrian Althoff. Thank you, sir, you may begin.

### **Adrian Althoff**

Thank you, Operator.

Good morning and welcome, everyone. We very much appreciate your participation.

Armando Tamez, our CEO, will lead off today's call by providing an overview of business and financial highlights from the quarter. Alberto Sada, our CFO, will then discuss our financial results in more detail. Afterwards, we'll open up for a Q&A session.

Before we get started, let me remind you that information discussed on today's call may include forward-looking statements regarding the Company's future financial performance and prospects, which are subject to risks and uncertainties. Actual results may differ materially and the Company cautions not to place undue reliance on these forward-looking statements. Nemak undertakes no obligation to publicly update or revise any forward-looking statements whether as a result of new information, future events or otherwise.

I will now turn the call over to Armando Tamez.

**Armando Tamez**

Thank you, Adrian.

Hello, everyone, and welcome to Nemak's Third Quarter 2021 Earnings Webcast.

As described in our earnings release, we saw more challenging conditions in our industry in the third quarter compared to the same period last year, which impacted customer light-vehicle production and, therefore, our volumes on a year-on-year basis. These effects were mainly associated with the emergence of operational disruptions in the global semiconductor supply chain, particularly in Southeast Asia. It had a widespread impact on semiconductor supply and light-vehicle production in the period.

Year-on-year volumes finished down 23%, which in turn represented the main factor behind a 35% decrease in EBITDA. Notwithstanding increased uncertainty over short-term light-vehicle production trends, I would like to emphasize that we've continued to see an overall favorable backdrop on the demand side. For example, in the United States, light-vehicle inventories dropped to an average of 22 days at quarter-end, representing a 61% year-over-year decline. Based on our consultations with customers and industry experts, we believe that weakened supply chain developments are in effect putting a temporary damper on light-vehicle availability and therefore sales. Consequently, we believe that the combination of historically low inventory levels and positive underlying fundamentals will continue to represent a key potential driver of pent-up demand, which could in turn support industry recovery once supply chains begin to normalize.

Going forward, we intend to remain nimble in response to the volume trends. To this end, we aim to adapt our operations as needed to maintain financial discipline while continuing to meet customer requirements. Given our experience and track record of navigating periods of volatility, I am confident that we are well prepared for the challenges ahead, regardless of the evolution of short-term industry dynamics.

Turning to our sales and marketing activities, I am proud to share that we reached a new milestone in our efforts to capitalize on emerging electrification and light (inaudible) trends, winning contracts to produce e-mobility and structural applications for approximately \$150 million annually. As a result, our order book in the segment increased to \$1.05 billion, surpassing our \$1 billion target earlier than anticipated.

Demand highlights from the quarter included business to supply battery housing for fully electric SUV applications of our U.S.-based OEM, which will involve the expansion of our battery assembly capacity in North America.

Additionally, we leverage existing capacity in the region to produce complex new motor (phon) housings for a leading global manufacturer of electric vehicles, representing original goals (audio interference)

customer, and to produce chassis parts for fully electric applications of the European OEM, also, using existing capacity in the region.

Taken together, this new business positions us to accelerate our growth trajectory in highly (inaudible) e-mobility and the structural applications in the coming years. Based on our accumulated business awarded to date in these segments, we expect that we will be the largest independent producer of battery housings for growing (phon) hybrid vehicles, as well as new motor components from fully electric vehicles in the world, and the largest independent producer of battery housings for fully electric vehicles in North America all by 2025. Given our footprint and talent, along with the leading technology portfolio spanning castings as well as (inaudible) and assembly processes, I am confident that we will continue to advance in tandem with our customers towards the electrified future of automotive mobility.

Rounding out the commercial highlights, I am also pleased to share that we were awarded incremental business to supply cylinder heads and engine blocks to high-volume applications of our North American OEM, reinforcing our global relative position in powertrain applications. In total, in the third quarter, (inaudible) contracts across our product lines was a total of approximately \$500 million annually. Two-thirds of this represented incremental business. Additionally, you may have already seen in our earnings release, we were honored to be recognized as the top supporting global supplier at our Twenty-Third Annual World Excellence Awards which was held just last week. We received two World Excellence Awards at the event, putting a spotlight on our efforts to exceed expectations and achieve the highest level of excellence in technology, quality, cost, performance and delivery.

Moving on to the manufacturing side, we made substantial new growth in the quarter towards ramping up our e-mobility and structural applications business, particularly in Europe where we successfully initiated (inaudible) production of new structural parts, which includes drive safety requirements of fully electric vehicles along with new highly engineered battery housing for hybrid electric vehicles. In both instances, we are harnessing existing capacity to deliver tailor-made solutions to the customer.

I would also like to highlight that the increased production of e-mobility and structural applications year-over-year, notwithstanding effects of the semiconductor shortage in the period. As a result, we remain on track to more than double the size of this segment in terms of revenue generation compared to last year.

I would now like to move on to corporate matters. As many of you already know, following approval at our General Extraordinary Shareholders Meeting held this past July 29, the merger of Controladora Nemark into Nemark was completed successfully on September 6. This marks the combination of our mortgage debt process with (inaudible) from Alfa, our former parent company, which began last year. As mentioned in previous communication, we see this as an important milestone regarding value creation for our shareholders and we are confident that having a single listed entity with the higher stock float (phon) will ultimately have a positive effect on our shared liquidity, in turn helping us to growing our investor base.

I would also like to take this opportunity to remind you about our upcoming Virtual Investor Day event, which will be held on Wednesday, November 10. As you may already know, the event will feature the participation of several members of our Management team, with a focus on recent development, strategy, technology and the outlook for the Company. We look forward to seeing you there.

With that, I would like to hand the call over to Alberto.

**Alberto Sada**

Thank you, Armando, and good morning, everyone.

I will walk you through our financial performance during this third quarter and provide additional context on industry trends, as well as drivers of our business.

During the third quarter of '21, light-vehicle sales decreased year-over-year in all our regions, as vehicle production along with vehicle availability remained constrained, due mainly to widespread disruptions in the supply of semiconductors to OEMs. As a result, North America and Europe, our main markets, saw annualized light-vehicle sales finish 13% and 16% lower respectively.

Turning to light-vehicle production, North America and Europe saw year-over-year reductions of 23% and 22% respectively. Semiconductor supply and demand dynamics proved challenging worldwide during this period. Notwithstanding an easing of certain supply chain bottlenecks, such as the Renesas plant in Japan, which returned to near-normal production levels after being impacted by a fire in the first half of the year, pandemic-related effects contributed to a reduction in semiconductor supply in other regions, particularly in Malaysia, where the spread of the Delta variant caused temporary production stoppages at the facilities.

Overall, industry conditions proved substantially more challenging than we, along with the consensus of the industry analysts, had expected going into the quarter. This in turn has put us on a lower-volume trajectory for the full year than we had anticipated last quarter.

At the same time, it's important to keep in mind that light-vehicle inventory levels remain historically low, particularly in North America, which in turns represents a potential catalyst for light-vehicle production going forward. To illustrate this point, at the end of the third quarter, light-vehicle inventories in the U.S. stood at an average of 23 days' supply, compared to more than 90 days earlier last year.

Given the combination of these inventory levels and a continued favorable demand backdrop, we remain optimistic on prospects for a sustained recovery in light-vehicle production, once supply chain conditions begin to improve.

Turning to the rest of the world, light-vehicle sales and production showed reductions of 14% and 17% in China, whereas in Brazil, they finished 14% and 23% lower in the period respectively, mainly due to the factors I just described.

Nemak's total volume was 7.8 million equivalent units in the third quarter, showing a year-over-year reduction of 23%, mainly on customer production reductions linked to the semiconductor shortage as previously described. Additionally, keep in mind that the third quarter last year was marked by a pronounced bounce-back effect after the reopening of the automotive manufacturing operations worldwide. In turn, lower volume was partly offset by higher aluminum prices, as revenue for the quarter finished at \$860 million, representing a 4% year-over-year decrease.

In response to the volatility we're seeing in our industry environment, I want to emphasize that we continue to take important steps to reinforce our financial position while remaining well placed to address any additional challenges that may arise. This includes expanding efforts to deliver operational efficiencies, all while maintaining our quality standards, as well as a stable supply to customers.

EBITDA in the third quarter amounted to \$115 million, which compares to the \$178 million reported the same period last year, mainly driven by volume effects associated with the semiconductor shortage. Nevertheless, we maintained unitary margins above pre-pandemic levels, finishing the period with a unitary margin of \$14.70, with continued support from product mix, as well as operational efficiencies achieved during the last six quarters.

Operating income in the quarter was \$28 million, mainly influenced by the same factors that affected EBITDA. This compares to the \$100 million reported in the same period last year.

Net income was negative \$29 million, which compares to the \$90 million reported in the third quarter of 2020. This result was mainly related to the same factors affecting operating income, together with nonrecurring financial expenses related to the prepayment of the now-cancelled bond issuance from '17 and '18, and negative noncash currency effects.

On the Capex side, we continue to advance with our planned investment schedule for the year, recording investments of \$82 million in the quarter. As mentioned in previous earnings webcasts, we are keeping our focus on supporting new product launches in e-mobility and structural applications. For the full year, we continue to expect to allocate more than half of what we consider strategic Capex to this business segment.

As of September 30, net debt was \$1.45 billion, 7% higher than that of close of the second quarter, mainly due to the incremental working capital requirements. At the end of the quarter, our net debt to EBITDA and interest coverage ratios were 2.5 times and 5.2 times respectively. Excluding the effects related to the prepayment of the bonds, our interest coverage ratio would have been 6.9 times. We believe that we remain well positioned to bring our net debt to EBITDA ratio back towards a 2.0 times, once industry conditions normalize.

Turning to working capital, we remain well positioned to respond to volume fluctuations, in part through increasing our inventory levels of finished goods, work in progress and raw materials, in order to be ready to increase shipments to our customers once supply chain disruptions in the industry begin to ease, while at the same time gaining additional flexibility to adjust production schedules without compromising our ability to meet customer requirements. On top of the effects I just described, aluminum prices also contributed substantially to a higher balance in inventories at quarter end.

Moving onto the regional results in the quarter, North America volume amounted to 4.3 million equivalent units, 27% lower year-over-year, mainly due to effects of the industry supply chain issues which I already described. In turn, year-over-year revenue reflected a combination of lower volume and higher aluminum prices, finishing at \$464 million in the quarter, which compares to the \$491 million in the same period last year. EBITDA was \$56 million, which compares to the \$105 million in the same period from the previous year, as the industry conditions weighted ( ) volume in the region.

Europe volume reached 2.6 million equivalent units, 16% lower year-over-year, mainly related to OEM production reductions. Revenue finished at \$288 million, which compares to the \$301 million in the same period last year, as higher aluminum prices partially offset effects of lower volume. In turn, EBITDA amounted to \$48 million, which compares to the \$63 million we saw in the same period last year, mainly due to the already mentioned volume effects.

Rest of the world volume was 0.9 million equivalent units, down 18% as lower customer production affected demand in China and Brazil. In the case of China, local power stoppages also weighted on our production. However, in terms of revenue, higher aluminum prices more than compensated for the effects of lower volume, resulting in a quarterly figure of \$108 million, a year-over-year increase of 5%. EBITDA in the region was \$11 million, a year-over-year increase of 6%, due mainly to the one-time effect of a release of cost accruals in the amount of \$3 million.

With that, I conclude my section and I will hand over the call to Armando for closing remarks.

**Armando Tamez**

Thank you, Alberto.

I would now like to provide an update on our outlook. Looking ahead to the end of the year and based on our conversations with customers and industry experts, we believe that the global semiconductor shortage will likely continue to affect light-vehicle production levels of OEMs, and therefore our volumes. While we see these headwinds as temporary in nature, they have taken longer to abate than we had previously expected. As a result, we now expect to finish the year with volume 8% to 9% below that of our July guidance. In turn, considering our continuous limitation of cost reduction initiatives, we expect that these will translate into a (inaudible) of 7% to 8% on the EBITDA side.

Given recent trends in aluminum prices, we will expect to see a less pronounced reduction in revenue of 2% to 3% compared to guidance.

Notwithstanding these developments, I would like to take this opportunity to reiterate our view that demand side fundamentals remain solid in the industry, driven in part by continued favorable consumer dynamics in North America and Europe. We are confident that we will be well positioned to ramp-up production further and deliver substantially stronger results once supply chain conditions begin to normalize. Moreover, we expect that the order book in our e-mobility and structural applications segment, which now stands at over \$1 billion in annual revenue, as I mentioned earlier in this presentation, will become a progressively more important driver of our results as we continue to ramp-up production of these parts in the coming years.

With that, we conclude our presentation and will now open the call for Q&A.

Operator, please instruct the participants on how to place their questions.

**Operator**

Our first question comes from the line of Marcelo Motta with JPMorgan. You may proceed with your question.

**Marcelo Motta**

Hi, everyone, good afternoon, thank you for taking my question.

I just wanted to confirm the details on guidance, right, just to make sure that we got the numbers properly. Now the Company sees volumes 8% to 9% below the guidance, and here I believe is the guidance that was announced together with the second quarter results: EBITDA would also be 8% to 9% below guidance, and top line, 2% to 3%. Just want to make sure that those are the numbers that we understand we got it correctly, and then I will ask the second question.

**Armando Tamez**

Yes, Marcelo, you're right. To be more precise, our guidance related to volume right now stands at the range between 35.9 to 36.3 million equivalent units, and our guidance in terms of EBITDA, it's going to be between 552 and 558 million, which was the previous guidance that we have. That's basically what we're expecting for the rest of the year.

**Alberto Sada**

Yes, percentage-wise it's a little bit lower than volume. Volume is 8% to 9% and EBITDA, 7% to 8%.



**Marcelo Motta**

Perfect. Thank you very much.

Then if you could give additional comment on the EV and structural component. I mean, you guys already reached before expectations, the threshold of \$1 billion in potential annual revenue. During the call you mentioned that, potentially in 2022, the contribution of these segments to revenues will be twice the level of this year, and if I'm not mistaken, in previous calls, the Company had mentioned about \$350 million to \$375 million as potential revenues on this segment. Just wanted to understand if when we look at this \$1 billion, it is very likely that as much as \$700 million, \$750 million will be already posted to impact in the revenues in 2022.

**Armando Tamez**

No. No, Marcelo, what we're expecting for EVs and structural components revenue for this year is a range between \$350 million and \$370 million, which is more than double of what we had as revenues last year. Last year we ended with approximately \$170 million in revenue coming from these segments. Now we are more than doubling our revenues. As I indicated in my presentation, we have already contracts to reach revenues of approximately \$1.05 billion, which is higher than originally anticipated. We set original target to reach \$1 billion by 2022, so we're very happy to see that our customers are responding to our value proposition and giving us contracts that are exceeding our initial guidance in terms of revenues for this segment.

**Marcelo Motta**

Perfect, very clear. Thank you very much for the clarifications.

**Armando Tamez**

Thank you, Marcelo.

**Operator**

Our next question comes from the line of Alfonso Salazar with Scotiabank. You may proceed with your question.

**Alfonso Salazar**

Thank you, and thank you for the call.

The question that I have is regarding the auto industry. Given that capacity is limited, and unless OEMs decide to invest in new capacity, what do you think is going to be the ability to serve the pent-up demand in North America and in Europe, or the markets where you serve? Because we saw the impact of the COVID, we are now facing the impact of these semiconductor crisis that spill a little bit in 2022. Eventually, there's going to be a rebound in production, and that's what we are anticipating. But the problem is that the capacity (inaudible).

How do you see that coming back to normal and to what level, so that if you have any sense on what to expect in 2022?

**Armando Tamez**



Yes, thank you, Alfonso, good question.

Certainly, in terms of the semiconductor issue, that is certainly limiting the availability of these components to, at the end of the day, build new vehicles. That is putting a big toll on the entire industry, including our Company. Unfortunately, we change our guidance based on expectations from customers and industry experts, just last quarter, and we're very sorry that we did that, based on, again, in good faith and information that we receive both from customers and industry analysts. They expected that this problem will be gradually resolved in the third and fourth quarter. Unfortunately, we have a big surprise that the third quarter was worse than the second, in terms of vehicles losses.

One thing that I think is important for the audience to remember is that new vehicles, they have, on average, between 200 to 300 semiconductors. It goes in the entire vehicle; almost all components have now semiconductors, from tire pressure to engine management to everything, infotainment, you name it. The customers unfortunately have very low visibility because they have so many suppliers that build components with semiconductors, and for them it's extremely difficult and challenging to assess where they are. Our customers are giving us two to three weeks' visibility in terms of volumes.

It is expected, Alfonso, that on the fourth quarter, it is going to get a little bit better than the third quarter, and based on analysts and customer forecasts, they're expecting that these may go all the way to '22, gradually recovering in the first half, and hopefully on the second part of the year we will have a better recovery. The industry unfortunately is facing these issues, and certainly we will keep a very close look to see how we can plan.

I think Alberto just mentioned that, and as part of our strategy, we built additional inventory to have more flexibility for potential down weeks, based on the inventory levels that we have available. Yes, we will watch these very closely, but unfortunately it is something that is affecting the entire industry.

**Alfonso Salazar**

Thank you, that's very helpful. Thank you so much for the answers.

**Armando Tamez**

Thank you.

**Operator**

Our next question comes from the line of Alejandro Azar with GBM. You may proceed with your question.

**Alejandro Azar**

Hello, Armando, Alberto. Two quick questions. Thank you for taking my...

But the first one is on the EV and (inaudible) business. It is my understanding that you currently have contracts for four electric battery housings for two OEMs. Did you gain another client with the recent awarded programs on these product lines?

The second one is for Alberto, on guidance. As your volume has come down, do you still expect Capex to be \$380 million going forward? If, on account of working capital, we have lost almost \$300 million in these nine months, do you expect to recover some of that losses in the fourth quarter, or we should expect, given you need to replenish your inventory, another hit in the fourth quarter? Thank you.

**Armando Tamez**

Yes, thank you, Alex.

Certainly for us, it was a very challenging quarter in terms of volumes; but very fortunately, we had a very strong quarter in terms of our commercial activities. As I indicated in my presentation, we got \$500 million worth of new contracts, which is the highest quarter since 2018, and that was very positive on the commercial side. We're very proud to say that out of the \$150 million, 80% came on the electric side.

We bought new customers as well as new products and we're very happy, as I indicated in my presentation, that will put us in a very solid position to become the largest producer in the world for battery housings, as well as EV components, and the largest also in North America. We're developing relationships with new customers, some of them new for us, which I think is very positive, and they are trusting our Company.

**Alejandro Azar**

If I may, and without putting names, did you mention on your remarks that you gained contracts from a few electric OEMs?

**Armando Tamez**

That is...

**Alejandro Azar**

Just to clarify.

**Armando Tamez**

Alex, yes, that is correct. It is a customer that, unfortunately, we have confidentiality agreements, we cannot identify their name, but is a customer that produces electric vehicles and is a leading company.

**Alejandro Azar**

Perfect, thank you, Armando.

**Armando Tamez**

Thank you.

**Alberto Sada**

Alex, related to—sorry, just for the second question from Alejandro, related to your question on guidance. On the two topics that you were just highlighting, on the Capex side, we should be ending the year with slightly lower than what we had originally guided for but pretty much in tune for that. Remember that on the Capex side, this is Capex intended for business that we'll be launching in the next year, year and a half, so it has nothing to do with, let's say, the short-term volume performance. We do manage, in some of that, the investments, particularly if certain capacity becomes available, but it's just a time difference versus when we need to include that.

Related to net working capital, as I indicated, certainly, this is putting a toll on our balance sheet. I think it's important to highlight that a little bit—I would say about half of the increase in working capital has to do with aluminum prices, which have a weight on the valuation of our inventories, both from finished goods, work in process, as well as raw materials. Half of that effect is there; the other half is the additional inventory that we have in place to be prepared for the potential pick-up of volumes when the supply chain issues stabilize within the industry.

By the end of the year, as usual, we have the seasonality effect on working capital, so we expect to recover part of this, but we'll keep a little bit of that extra balance because of the higher inventory and increased prices in aluminum.

**Alejandro Azar**

Thank you. Thank you both.

**Armando Tamez**

Thank you, Alex.

**Operator**

Our next question comes from the line of Abraham Fuentes with BlackRock. You may proceed with your question.

**Abraham Fuentes**

Hi, hello.

I have two questions, the first one's already answered, it was about the semiconductors shortage view.

I will ask just the second question. When can we see more details on the electric vehicle and semiconductor in your press releases? It will be very useful for us to see the impact and your view, and all the details that you are seeing going forward for the next years.

**Alberto Sada**

Yes. Yes, certainly, thanks for the question, Abraham, this is Alberto.

As the size of the structurals and EV business becomes larger, we'll be in a position to give a little bit more breakdown about the impact that that business would have on our bottom line. I think right now we are, let's say, in the phase of building up that business. But for sure, potentially sometime next year, we should be able to give a little bit more flavor of how the results split between the two businesses.

**Abraham Fuentes**

Okay, thank you.

**Operator**

Our next question comes from the line of Andres Cardona with Citigroup. You may proceed with your question.

**Andres Cardona**

Hi, good morning, everyone. It's Andres Cardona from Citigroup.

My question is to do with margins. Sorry, I connected late, but if you can explain why you were able to defend the margins, right. It seems on the margin that there was some sort of good news there. If you can share your outlook for the third quarter, if we should expect some improvement as long as volumes progressively come back.

**Alberto Sada**

Yes, Andres, thanks for highlighting that. Certainly, as we indicated on our message initially, and as we have, let's say, gained experience along the different cycles that we have gone through or for volume volatility, we have been able to implement very strict cost control measures along our different operations. We were able to effectively contain part of the volume reductions that we saw with cost reductions, as well with certain commercial agreements that we have with our customers to compensate for part of these shortfalls.

Between the two, we were able to gain from the EBITDA per unit side. That puts us higher than where we were prior to the pandemic. It's taking us to—if you do the math on our updated guidance, that number that we're seeing for the full year stands at close to \$15.40 per piece, which is higher than we had prior to entering this pandemic. It goes back all the way to the 2015-2016 timeframe where we had higher EBITDA per unit.

I think that talks on the fact that we as a Company are extremely well prepared to deal with volatility, and that we can sustain part of the cost reductions that we saw in the last quarters after the shutdowns of last year. We expect that to continue giving us favorable news as we move forward with the recovery of the supply chain disruptions on semiconductor (inaudible) lines.

**Operator**

There are no further questions at this time. I'd like to turn the conference back over to Mr. Althoff for additional or concluding remarks. Sir?

**Adrian Althoff**

Thank you, Operator.

I would just like to thank everyone for participating in today's event. Please feel free to contact us if you have any follow-up questions or comments, and have a good day.

**Operator**

This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation, and enjoy the rest of your day.