

Nemak
3Q24 Earnings Conference Call
Thursday, October 17th, 2024

Speakers

- Alberto Tamez Chief Executive Officer
- Alberto Sada, Chief Financial Officer
- Denise Reyes, Investor Relations Officer

Operator: Good morning, everyone, and welcome to Nemak's s third quarter 2024 earnings webcast. Armando Tamez, Nemak's CEO; Alberto Sada, CFO; and Denise Reyes, 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 will now turn the call over to Denise Reyes.

Denise Reyes: Thank you, operator. Good morning, and welcome everyone. We greatly 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 will open for a Q&A session, which participants may access live, or written on the Q&A function.

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 you not to place undue reliance on these forward-looking statements. Nemak undertakes no obligation to publicly update or revise any forward-looking statements, whether because of new information, future events, or otherwise. I will now turn the call over to Armando Tamez.

Armando Tamez: Thank you, Denise. Hello everyone, and welcome to Nemak's Third Quarter 2024 Earnings webcast. During the period, we made progress on internal initiatives directed at improving margins, alongside commercial negotiations to elevate our topline. From an industry standpoint, global light-vehicle sales declined, while production was scaled back to manage and normalize inventory levels in our main regions.

In the third quarter, EBITDA grew 3% year-over-year to 169 million dollars, despite a 9% decline in volume. Additionally, we have consistently reduced capital expenditures by 26%, maintaining a steady downward trend throughout the year.

Commercial negotiations continue apace. Some of these efforts are focused on achieving sustainable margin improvement in our ICE powertrain segment, addressing labor inflation recovery and re-pricing products that fall below our profitability targets. As the lifetime of ICE light vehicles extends due to the slowdown of electrification, we anticipate ongoing benefits to our margins and overall profitability.

The remaining commercial negotiations aim to compensate for under-utilized capacity in the e-mobility, structure, and chassis applications segment, and to accelerate deleveraging efforts. Overall, I am positive about the progress we have made, and expect to conclude the negotiations in the fourth quarter.

Moving on to awarded contracts, we have accumulated approximately 220 million dollars in awarded business this year. Of this total, 40% corresponds to ICE vehicles, while the remaining 60% is directed towards platforms where customers offer both ICE and hybrid variants.

In line with this trend, we are seeing an increase in the pipeline of requested quotations for hybrid vehicles, which aligns well with our product portfolio. Our range of lightweighting solutions for hybrid vehicles includes ICE powertrain and structural components, as well as battery housings and other e-mobility components. Overall, the content per vehicle surpasses that of the traditional ICE segment, creating new commercial opportunities for Nemak.

I would also like to underscore the flexibility of our casting technologies, which are compatible with the components required for hybrid vehicles.

Continuing with our strategy execution, during the quarter we successfully launched and started production of a battery housing for a full-electric commercial vehicle from a leading, Europe-based manufacturer. To fulfill these orders, we tapped into our existing high-pressure die casting capacity. Given the considerable size and battery capacity requirements of these units, we are providing 23 battery housings per commercial vehicle produced. Moreover, this project reaffirms the contributions of aluminum in reducing the weight of electric vehicles, further improving their battery range and efficiency.

Turning to other highlights, I am pleased to share that Nemak is featured in five of Wards 10 Best Engines & Propulsion Systems awards this year. While the electrification revolution is well underway, OEMs are also embracing a wide variety of hybrid solutions, as showcased by this year's awarded vehicles, which include six hybrid models.

We are proud to offer cutting-edge components to our customers and to embody the spirit of innovation in delivering lightweighting solutions. Our engineering center offers the perfect environment for early strategic

collaboration, supporting the development of new technologies. We are currently working on several projects to innovate our assembly processes, specifically in the surface treatment and joining mechanisms. With our expertise in 3D printing, simulation models, and our ability to predict how joints and materials will perform, we deliver innovative lightweighting solutions that enhance efficiency for our customers.

Before I conclude, I would like to share that Nemak has received the 2024 Top Employer certification at our sites in Brazil, Germany, Mexico, Poland and the United States. This recognition underscores our commitment and dedication to creating a positive work environment, where employees feel valued and motivated, ultimately contributing to our overall success and innovation. This concludes my initial remarks. Thank you for your attention, and I will now hand off the call to Alberto.

Alberto Sada: Thank you, Armando, and good morning, everyone. I will begin with an overview of industry trends, followed by a discussion of our financial results for the third quarter of 2024.

During the quarter, we achieved a 3% year-over-year increase in EBITDA, driven mainly by progress in commercial negotiations and operating efficiencies. This result was accomplished despite a 9% reduction in volume due to lower customer production and a slower growth rate in EV adoption.

Moving to industry figures, during the quarter, the seasonally adjusted annual rate for light-vehicle sales in the US was 15.6 million units, similar to the same period last year. Demand in the US remains resilient given stable overall economic conditions where consumer confidence remains positive, and incentives continue to increase.

In turn, light-vehicle production in North America decreased 3.8% compared to the same period of last year, totaling 3.8 million units; as our customers adapt their production schedules to optimize inventory, particularly Stellantis which saw its production reduced by 28% year over year.

In Europe, SAAR sales decreased by 4.7% year-over-year to 15.4 million units. This figure compares lower to an abnormal high figure last year, which was influenced by government incentives for hybrids and fully-electric vehicles. Following the trend in light-vehicle sales, production in the region decreased by 3.7% year-over-year, due to price sensitivity.

In China, the seasonally adjusted annual rate for sales was 27.6 million units, 7.6% lower than last year, as we see some consumers delay vehicle purchases on the expectations of lower future pricing. Production in the region decreased by 2.1% to 7.3 million units, reflecting lower domestic demand, although this was partially offset by exports.

In South America, the automotive market in Brazil recorded a 9.6% increase in light-vehicle sales, rising to an annualized level of 2.5 million units. Consumer demand continues to be fueled by favorable financing costs and to certain extent to the recovery of sales following recent floodings. Production in Brazil increased by 7.5% to 0.6 million units, in line with growing consumer demand.

Turning to our financial results: during the third quarter, Nemak's volume was 9.6 million equivalent units, 9% lower year-over-year. This decline was primarily due to reduced vehicle production in North America and lower production of EV components. Consequently, revenue was 1.2 billion dollars, reflecting a 4% decrease year-over-year due to the lower volume, partially offset by a more favorable product mix and commercial negotiations.

Notably, EBITDA was 169 million dollars, 3% higher than in the same period last year, driven by commercial negotiations and operational efficiencies. These factors more than offset the impact of lower volume and labor inflation. Furthermore, EBITDA per equivalent unit increased to 17.6 dollars, boosted by progress in customer negotiations.

Operating income was 73 million dollars, 4% lower year-over-year, as higher EBITDA was more than offset by the effect of accelerated depreciation of idle operating assets, and the favorable effect of other income of last year.

Net income totaled 5 million dollars, as our result was affected by the non-cash effect of currency exchange from our Euro denominated liabilities partially offset by lower income taxes. Absent of this effect, Net Income would have been close to 33 million dollars. Year-over-year, net income compares to 25 million dollars.

Regarding our balance sheet, by the end of the quarter, Nemak's net debt was 1.77 billion dollars, a 12 million dollars sequential increase. During this period, cash flow improvements were more than offset by the effect of the appreciation of the Euro on our Euro-denominated loans, which totaled approximately 22 million dollars. Furthermore, we have pending commercial claim collections that we expect to clear during the fourth quarter, which affected our working capital.

As a result, the net-debt-to-EBITDA ratio was still at 2.9 times by the end of the quarter. We continue to prioritize cash flow generation, aiming for further improvement by the end of the year, supported by net working capital recovery, commercial negotiations, and efforts to contain capital expenditures. Additionally, the interest coverage ratio was 5.0 times, compared to 4.7 times in the previous quarter.

I would like to highlight that we continue with our journey to improve our debt profile structure. During this quarter, we secured a 250 million dollars debt transaction, whose proceeds were used to repay short term debt. The debt facility was structured as a 5-year bullet loan with a SOFR-based variable interest rate. The transaction improved our average debt maturity profile from 4.2 to 4.8 years maintaining our average cost of debt. This facility showcases the ability we have to tap on multiple financing markets and the confidence that the banking community has on Nemak.

Regarding capital expenditures, Nemak invested 96 million dollars in the third quarter, 26% lower than the same period of last year, as we continue to deploy capital in the most optimal way by reducing capital expenditures and reutilizing existing production assets wherever possible.

Moving to our regional results. During the third quarter, revenue in North America decreased 11% year-over-year to 636 million dollars, due to lower production from our customers, particularly Stellantis, as well as lower demand for EV components. This was partly offset by commercial negotiations, and a favorable product mix. In turn, EBITDA was 78 million dollars, down 10% year-over-year. Continuous progress on customer negotiations and the depreciation of the Mexican peso were more than offset by volume reduction, continued labor cost inflation, and additional launching expenses.

In Europe, revenue increased 3% year-over-year to 419 million dollars as commercial negotiations more than offset lower volume. In turn, EBITDA in the region was 68 million dollars, 19% higher compared to the same period of last year, on the back of commercial negotiations and operating efficiencies.

In the Rest of the World, revenue increased 14% year-over-year, totaling 169 million dollars, primarily due to higher volume and improved product mix. EBITDA in the region rose 13% to 23 million dollars, benefited from volume, product mix, and sustained operating efficiencies.

Generating value for our shareholders remains our top priority. We are committed to streamlining our operations and maximizing the use of our existing assets. By working closely with our customers and conservatively allocating capital, we ensure that every investment is strategic and effective. Our focus on generating free cash flow remains strong, as it is crucial for reducing leverage and enhancing our competitive position. This disciplined approach not only improves profitability but also positions us to lead in innovating of lightweighting solutions for the automotive industry.

We are dedicated to driving sustainable growth and delivering long-term value. Thank you for your continued trust and support as we navigate the future with confidence and determination.

Thank you for your attention. I will now turn the call back over to Armando.

Armando Tamez: Thank you, Alberto. Considering the significant progress we have made, we are pleased to announce that we expect to exceed our initial EBITDA guidance, despite the volume challenges highlighted in recent industry forecasts. Our financial results will be strengthened by both recurring and one-time commercial negotiations. Consequently, we are updating our EBITDA guidance to 640 million dollars, from a previous range of 570 to 600 million dollars. We are confident that these efforts will support the Company's long-term financial health. As we continue to navigate the evolving automotive landscape, we remain committed to delivering value to our shareholders. This concludes my remarks. Thank you for your attention, and I will now hand off the call to Denise Reyes.

Denise Reyes: Thank you, Armando. We are now ready to move on to the Q&A portion of the event; participants may ask questions live via webcast, or through the Q&A function. Operator, please instruct participants on how to place their questions.

Operator: If you would like to ask your question live, please press the 'Raise Hand' button at the bottom of your screen. When it's your turn to ask a question, you will be granted permission to speak. Questions will be addressed in the order that they are received, calling the name of the next person on the line. You may also place a written question using the Q&A function, also located at the bottom of your screen. Questions will be addressed in the order they are received. We will now open the floor for questions. Our first question comes from Marcelo Motta with JP Morgan. Marcelo, please proceed with your question.

Marcelo Motta: Hi everyone, thanks for taking my question. I have two questions. The first is regarding the commercial negotiations. Can you provide more details about the one-off impact during this quarter and how much will be the long-term impact of these negotiations? The second question is regarding Capex. Historically, the company's annual Capex has been around fifty to sixty percent of EBITDA. This year's level it's definitely going to be lower than that, I'm wondering what we should consider as a more normalized level of Capex compared to EBITDA, what is your minimum Capex for maintenance, any color on that front would be very helpful. Thank you.

Alberto Sada: Okay. Thank you for your questions, Marcelo. Related to the commercial negotiations, as we highlighted, this is a combination of both one-time claims as well as recurrent ones. But as you may be aware, some of these negotiations have been very special, and due to the nature of those negotiations, we have been asked not to reveal how much of the details are included. So, all I can say is that it's a combination of both. Certainly, we have the push towards having those negotiations being as recurrent as we can, so we should be seeing some of these adjustments improved margins going forward.

Armando Tamez: Yeah. Thank you, Marcelo, for the second part of your question, related to Capex. What we can tell you is the following: over the last three to four years, the company has been investing heavily to transform, to move more into structural components as well as EVs. As has been indicated before, we are seeing a slowdown in electric vehicle sales in North America and also in Europe. Based on that, what we are seeing is a significant increase in demand for ICEs as well as hybrids. For that reason, we expect to significantly reduce our Capex over the next three to five years. We already have the assets and we are prepared and flexible, depending on what customers are willing to buy. But the company will significantly reduce its Capex expenditures over the next three to five years.

Marcelo Motta: Perfect. Very clear. Thank you very much.

Armando Tamez: Thank you, Marcelo.

Operator: There are no further live questions at this time, I'd like to turn the conference back over to Ms. Reyes to address the questions placed via the Q&A function of the webinar.

Denise Reyes: Thank you, operator. We have a set of questions from Declan Hanlon from Santander. The first question is: what was the rate of the recent five-year loan that you completed last month? And the second question is: can you provide an update on the total available in your committed credit line facilities at the third quarter?

Alberto Sada: Thank you for your question, Declan. Yes, As we announced, we have engaged ourselves in a journey to improve our debt profile going forward. Together with that, we're also looking for ways to improve our overall cost. For that purpose, the five-year loan, as indicated in our press release, it came with a variable interest rate, SOFR based, with a margin slightly above 200 basis points. We believe this is quite competitive rate for a structure as we highlighted the five-year bullet loan transaction. Regarding the committed lines, these are an integral part of our strategy to ensure we have adequate funding available at all times. As of now, 100% of our committed credit lines remain available, amounting close to 400 million dollars.

Denise Reyes: Thank you, Alberto. A second question from Declan Hanlon from Santander: It looks like you will exceed your EBITDA guidance for the year. Do you also expect working capital cash generation in the current quarter to be sufficient to meet your earlier target for the year of 2.6 to 2.7 times net-debt-to-EBITDA?

Alberto Sada: Yes. Thanks for that question as well, Declan. Yes, We are not only expecting to achieve the numbers you referred to, but we believe we can be even lower than that. We still have plenty of working capital recovery to take place in the fourth quarter, which should generate sufficient cash, together with the new EBITDA forecast, to achieve 2.5 times net-debt-to-EBITDA by the end of the year.

Denise Reyes: Thank you, Alberto. And one follow-up from Declan Hanlon from Santander: How are the commercial negotiations evolving versus your objectives and plans?

Armando Tamez: Thank you, Declan. We have made significant progress in our commercial negotiations with most of our customers on both sides. As we have indicated before, we were able to reprice some products that were not meeting our profitability targets, as well as some recovery from some investments that we made we are not seeing the volumes materialize. So far, we've been successful in both areas. We are still in final negotiations, but we feel very confident that we will achieve almost 100% success by the end of this quarter.

Denise Reyes: Thank you, Armando. The next question is from Alfonso Salazar from Scotiabank, and it reads: Can you provide an update on your free cash flow expectations for the year? Do you still expect free cash flow in 2024 to be positive, and any color on free cash flow expectations for 2025? Thank you.

Alberto Sada: Thanks for the question, Alfonso. Well, as we highlighted, we still see a very important reversal of working capital in the fourth quarter, which overall is going to translate into potentially slightly positive free cash flow for the full year basis. So that's the expectation, and as indicated before, with the increase in EBITDA, we should see our leverage ratio come down to 2.5 times net-debt-to-EBITDA. For 2025, at this point, we cannot give too much color. We should be guiding the market later, early next year, in the next conference. But certainly, our view is to improve our cash generation potential as we continue to reduce capital expenditures, optimize working capital, and increase our EBITDA.

Denise Reyes: Thank you, Alberto. The next question is from Mariela Anguiano from Nomura: What does a Trump win mean for Nemak, given recent headlines that he plans to impose severe tariffs on vehicles imported from other countries, particularly China?

Armando Tamez: Thank you, Mariela. I think it's too early to tell. We still need to see who is going to win the election in the U.S. Second, I think we need to remember the rhetoric of some of the candidates. It's important to clarify that, in the event of any tariffs, we are selling all our products free on board from our plants in Mexico. So, if there are any additional tariffs or duties on the products, they will be 100% the responsibility of the OEMs, our customers. As I indicated, it's too early to tell. We'll be watching this, But I

think if, at the end, they impose tariffs on vehicles produced in Mexico, it will certainly affect the American consumer mainly.

Denise Reyes: Thank you, Armando. We now have a question from Javier Dosal from AM Advisors: Could you share an estimate or some color on how much of your 640 EBITDA guidance comes from the extraordinary compensation?

Alberto Sada: Certainly, as highlighted before, the negotiations were very special and confidential, so we cannot release specific data on how much of that result comes from those negotiations. But, as I said, the negotiations are a combination of both one-time and continuous effects of those improvements in pricing and claims.

Denise Reyes: Thank you, Alberto. The next question is from Rodrigo Sanhueza from Invex: Could you further elaborate on the expected reversal of working capital in the quarter? What is this related to?

Alberto Sada: Well, there are two effects there. On one side, we have the seasonal effect on working capital, which, as we know, at the end of the year, customers reduce operations, and that represents for us a release in overall working capital. That had a reversal effect earlier in the year as we saw changes in operating patterns. The second one has to do with some of the commercial claims that should be collected within the next few weeks. Some of them, as indicated, were closed at the end of the third quarter, and we should see the cash effect of those happening in the fourth quarter.

Denise Reyes: Thank you, Alberto. The next question is from Consuelo Salazar from Nummos Asesores Financieros: How are you forecasting demand and production of light vehicles in the USA, China, and Europe in 2025?

Armando Tamez: Thank you, Consuelo. What we are seeing, and certainly we are talking to several analysts as well as our customers, is a small recovery in the main regions, especially North America and Europe. This is related to lower interest rates, which will make vehicles more affordable. We are also seeing that now the OEMs have solved almost 100% of the issues with semiconductors, plus other issues they had with some suppliers; the availability of vehicles is increasing, as well as their affordability. So we are seeing a small, let's say, increase in demand and also production for the following year in the three main regions.

Denise Reyes: Thank you, Armando. We have a question from Alejandro Rojas from HSBC Mexico: Can you provide us more color regarding factors that affect EBITDA, such as labor inflation and the decrease in demand for EVs, and what is the time scope to overcome this?

Alberto Sada: Well, thanks for the question, Alejandro. As we have highlighted on previous calls, we have certainly been subject to a number of cost increases, which have been part of the negotiations with our customers. We have experienced labor inflation in multiple operations, where we are, particularly in North America, and that's an effect we've been able to compensate to a great extent through those commercial negotiations.

On the EV side, the decreasing demand is part of the explanation for why volumes have been dropping, particularly in North America. Again, that's also part of the compensations we've had engaged with our customers, which address both the unused capacity, where the claims obtained will be used to reduce our leverage, and the other one is adjusting pricing when scale doesn't meet the original expectations. This allows us to maintain an ongoing satisfactory profitability pattern on the EV side, certainly it's essential to see how the market evolves. At this point, we're seeing a reduction in the growth rate but still strong objectives to electrify the industry going forward. As we mentioned before, we are supporting the electrification side, both on battery electric vehicles and hybrids, which use the same type of components that we employ for our traditional legacy business.

Denise Reyes: Thank you, Alberto. There are no further questions at this time, and with that we conclude today's event. I would just like to take this opportunity to thank everyone for participating. Please feel free to contact us if you have any follow-up questions or comments and have a good day.

Operator: Ladies and gentlemen, this does conclude today's earnings webcast. Thank you for your participation. Have a wonderful day.