



NEMAK, S.A.B. de C.V.

First Quarter 2024 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

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Alejandro Azar, *GBM*

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

Operator

Good morning, everyone, and welcome to Nemak's First 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 conference call over to Denise Reyes.

Denise Reyes

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 will open for a Q&A session, which participants may access via dial-in or webcast.

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. Nematik 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 Nematik's First Quarter 2024 Earnings webcast.

During the quarter we improved our EBITDA and margins, on the back of operating efficiencies and solid volumes in the ICE powertrain segment. However, we experienced a slight decrease in our top line, which was compounded by mixed results in our main regions and lower aluminum prices. All together, EBITDA increased 10% and revenues dropped 4%.

In terms of financial performance, we are determined to continue delivering solid results that will lead to generation of cash, which will be allocated to reduce net debt and deleverage the Company. Our target remains a ratio of 2.0 times net debt to EBITDA, which we are confident we will achieve over time, as we capitalize on solid margins, and reduce investments.

In parallel, we have engaged in negotiations with our customers to address two main subjects. On the one hand, we have initiated negotiations with our customers to compensate for under-utilized capacity in the e-mobility, structure, and chassis applications segment. This situation follows the latest industry trends, which indicate a slowdown in electrification. For situations in which we have experienced volume fluctuations, and capacity is already installed, we are requesting commercial compensation to offset the associated impacts, and therefore prevent margin deterioration. Conversations with our customers have been productive and will evolve as volume unfolds.

On the other hand, we continue to face strong cost pressures, primarily stemming from labor cost inflation. We aim to recover these impacts through similar dynamics as in previous years, by negotiating price increases with our customers.

To further improve our margins and counteract cost pressures, we are determined to maintain a prudent financial approach, and have established a cost reduction program focused on identifying opportunities and creating a clear pathway to capitalize them. We are also evaluating strategic options for assets that are non-operating or have profitability below our thresholds, aiming to optimize our financial performance.

By combining the negotiations intended to improve our topline with our cost-reduction initiatives, I am confident that we will recover our solid margins.

Moving on to strategy execution, I want to reiterate the flexibility embedded in our strategy, which enables Nematik to participate in this dynamic market. Our current product portfolio serves the full range of light-vehicles, including internal combustion engine, hybrid, and electric models.

The components in our ICE powertrain segment have led the Company to a leadership position, and continue to represent the majority of our revenue base. We have ample capacity in the segment and outstanding know-how, with the ability to produce more volume if needed.

In the e-mobility, structure, and chassis applications segment we have also laid strong foundations to capitalize on the transformation of the automotive industry. While current trends point towards slower growth in electrification, Nematik is certain of the industry's electric future, and will continue to meet market demand, strategically positioning itself to smoothly transition towards sustainable mobility as the automotive industry continues to develop.

I would also like to emphasize that our structural components portfolio is comprised of propulsion-agnostic components that can be used in all vehicles, whether internal combustion engine, hybrid, or electric, and to that end, they are supportive of our flexibility strategy.

We have made progress on the commercial front, and were awarded business of approximately \$55 million, with 90% accounting for e-mobility, structure, and chassis components. This new business will use existing capacity and technology, while leveraging our trademark for innovation.

As a result, and maintaining our selective approach, our e-mobility, structure, and chassis applications order book stands at approximately \$1.8 billion.

Moreover, we successfully launched and started to produce new components in our European facilities. Our plant in Poland initiated production of two structural components, tapping into our existing high-pressure die-casting capacity. The components include a single large casting for BMW, and will be used across their internal combustion engine, hybrid, and electric vehicles.

Additionally, our facilities in Germany and Hungary launched different ICE powertrain components that include light-vehicle and motorbike applications. All projects were heavily supported by existing capacity and exceptional knowledge in casting technologies. Our innovative lightweighting principles proved their value, as we reduced the weight of one single component by more than 14 kilograms, further supporting light-vehicle efficiency.

Overall, I am pleased with the results from our operations in Europe and would like to extend recognition to our people in the region. The contributions I just mentioned in the launch of new programs, as well as the solid performance in Europe, have been invaluable for the Company.

Moving on to our sustainability agenda, I am proud to share that Nematik earned an upgrade on the CDP climate change questionnaire. We received a score of "A-", which denotes a transition from management to leadership level. This higher rating demonstrates that Nematik implements best practices in its strategy and actions to mitigate climate change.

CDP also awarded Nematik the Top Supplier Engagement rating of "A" for the third consecutive year, keeping us on the CDP's Supplier Engagement Leaderboard. This benchmark is comprised of pioneering companies that are driving the transformation of their businesses towards a zero-emissions future.

Another highlight in our sustainability agenda is the certification of three of our facilities by the Aluminum Stewardship Initiative Performance Standard. The certified plants are located in Brazil, Poland, and Slovakia, underscoring our responsible manufacturing practices, and sound governance throughout our operations. This rigorous ASI certification program is recognized as the most comprehensive voluntary, sustainability-standard initiative for the aluminum value chain.

These achievements highlight Nematik's progress on its roadmap towards a sustainable future, with efforts to mitigate climate change fully embedded in its business strategy.

As a final remark, and as part of our social agenda, Nematik Mexico received recognition as a Socially Responsible Company from CEMEFI, the Mexican Center for Philanthropy, for the fifth consecutive year. Our ESG practices are highlighted by this recognition, alongside a strong commitment to our talent and the communities where we operate.

This concludes my 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 Nematik's business performance for the first quarter of 2024, followed by a discussion of relevant industry trends and financial results.

During the first quarter, we achieved a 10% year-over-year EBITDA growth, despite lower volumes which led to a 4% year-over-year decrease in revenue.

With dynamics from previous years still in play, we are in discussions with OEMs to share the burden of inflationary pressures, including increased labor costs in the main regions where we operate. As a reminder, these negotiations are retroactive to January 1st. As mentioned in the previous earnings webcast, in addition to the inflation adjustments, we are currently negotiating compensations for idled installed capacity in the EV segment, as the projected electrification ramp-up rate has clearly slowed down. Nonetheless, these investments have placed us ahead on the learning curve in joining and assembly processes and set us in an outstanding position to capture additional business once the industry resumes the electrification pace.

Moving on to industry trends, as indicated before, the market is signaling a softening in the growth rate of electric vehicle adoption, which translates into a favorable scenario for Nematik, as we see higher volumes in the ICE powertrain segment, for which we have capacity in place.

During the first quarter, the seasonally adjusted annual rate for light-vehicle sales in the U.S. was 15.4 million units, 3% above last year. Demand for light vehicles in the region remained robust, as macroeconomic factors in the region remain solid, supporting light-vehicle demand.

In turn, first-quarter production in North America remained stable year-over-year at 3.9 million units. I would like to point out a significant change in the mix of light-vehicle sales in the region, as OEMs are prioritizing the ramp-up of recently launched SUVs, most of them with ICE propulsion.

In Europe, seasonally adjusted annualized sales increased 6% in the first quarter to 16.3 million units, on the back of pent-up demand and changes in the sales mix, which also included increased ICE vehicles. These results came despite challenging economic conditions, including a decline in government incentives.

During the first quarter, light-vehicle production in the region decreased 7% year-over-year to 4.1 million units, as production schedules continued normalizing compared to the first quarter of 2023, when we saw higher production to fulfill existing backlogs.

In China, the seasonally adjusted annual rate sales rose 8% year-over-year in the first quarter to 22 million units, supported by improved economic conditions and government initiatives aimed at stimulating the automotive industry.

In light-vehicle production, China posted 8% year-over-year growth for the first quarter, totaling 6.3 million units by quarter end. These increases were driven by strong exports and favorable domestic demand.

In Brazil, the seasonally adjusted annual rate of light-vehicle sales for the quarter was 2.2 million units, 15% higher year-over-year, aided by favorable domestic demand.

South America's light-vehicle production decreased 6% year-over-year in the first quarter of 2024, to 0.6 million units, due to continued inventory optimization.

Turning to Nemak's results, volume decreased 2% year-over-year, to 10.6 million equivalent units. This was due mainly to lower production among our customers, particularly in North America, and influenced by lower requirements in the e-mobility, structure, and chassis segment.

As a consequence, revenue in the first quarter was \$1.2 billion, 4% lower compared to the same period of 2023, due in part to the decrease in aluminum prices.

In turn, EBITDA was \$145 million, representing a growth of 10% year-over-year. This number was driven by customer negotiations and operating efficiencies, primarily in our European facilities.

As a result, EBITDA per equivalent unit for the quarter was \$13.7, 11% higher than the same period of 2023, and in line with the annual estimate included in our 2024 guidance.

In the first quarter, we reported an operating income of \$55 million, compared to \$49 million in the same period of last year, supported by EBITDA growth.

Net income totaled \$25 million in the first quarter, compared to a net loss of \$15 million in the same period of last year, as higher results in combination with foreign exchange gains offset higher interest expenses.

Moving on to our balance sheet, our working capital increased sequentially by \$120 million, associated with production increases in the first quarter 2024, consistent with seasonal trends.

As of the end of March, our net debt was \$1.7 billion, 8% higher sequentially, related to the increase in working capital just described. As a result, the net-debt-to-EBITDA ratio was 2.8 times versus 2.7 times in December of last year, while the interest coverage ratio was 4.6 times versus 4.8 times, in the same timeframe.

During the quarter, capital expenditures totaled \$104 million, 17% below the same period of 2023, as we streamlined investments to adapt to the industry's updated perspectives on electrification.

Moving to our regional results, during the first quarter North America revenue decreased by 12% year-over-year to \$616 million, due to the effect of lower volume and product mix. EBITDA was \$58 million, down 21% compared to the same quarter of 2023, as a result of a lower top line, the negative foreign exchange effect on the Mexican peso, and persistent inflationary pressures, mainly in labor. We continue actively working with our customers to address this year's inflation effects.

In Europe, revenue grew 5% year-over-year to \$446 million, driven by higher volumes, which was partially offset by lower aluminum prices. In turn, EBITDA in the region increased to \$70 million from \$43 million recorded in the same period of last year, favored by an improved product mix, lower energy costs, and commercial negotiations. These factors, together with operating efficiencies, more than offset inflationary effects in the region.

In the Rest of the World, revenue was 11% higher year-over-year, totaling \$150 million. This growth was primarily attributed to higher volume in Asia and improved product mix, which more than offset the decrease in aluminum prices. EBITDA in the region benefited from the volume, product mix and sustained operating efficiencies, resulting in a positive contribution of \$17 million, 6% higher versus the same period of 2023.

In other recent developments, during the quarter, we held the annual review process with rating agencies. Fitch Ratings and Standard and Poor's revised their outlooks to negative from stable, with Fitch maintaining its investment-grade rating, and S&P maintaining Nemak one notch below investment grade. Additionally, Moody's Ratings downgraded our credit rating to Ba2 from Ba1, keeping a stable outlook.

All of the rating agencies highlighted the Company's current liquidity and debt maturity profile as positive factors; nonetheless the increase in leverage derived from the investments in the new segment weighed on their decisions. I want to reiterate that in those cases where the capacity remains unused, we will seek compensation from our customers. In addition, we expect that as a consequence, the ICE lifecycle will extend, therefore, improving our cash generation, further reduction in the Capex needs, and continued use of existing capacity.

It is important to highlight that we are following a comprehensive approach to optimize operating results, including initiatives directed to improve our top line, such as the aforementioned commercial negotiations, and also including initiatives to improve our cost structure. These elements, in conjunction with disciplined capital allocation that prioritizes deleveraging, and maintaining capital expenditures within the range provided in guidance, will support our cash flow generation, and consequently our credit metrics in the coming periods.

To conclude my remarks, allow me to re-emphasize that a slower adoption of electric mobility translates into extended production of internal combustion engines and hybrid vehicles, which currently represent most of our revenue base. This gives us the opportunity to harness our existing assets, technology, and expertise, in the medium and long term. We are confident we will benefit from the changes in product mix between ICE and EVs and continue delivering value for our shareholders.

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

Denise Reyes

Thank you, Alberto. We are now ready to move on to the Q&A portion of the event. As a reminder, participants may ask questions directly via dial-in, or send questions in writing via web. Operator, please instruct participants calling in on how to place their questions.

Operator

(Operator instructions)

First question comes from Andrés Cardona with Citigroup. Please state your question.

Andrés Cardona

Good morning, Armando, Alberto. Thanks for the presentation. I have three questions. The first one, you were saying you are confident about recovering your target margins. Could you please share with us what are those targets? Not sure if you look at it on a per equivalent unit or however you think about is target margins. The second one is you were saying on the electric vehicle volumes that have been coming below

your expectations you're negotiating some compensations, right? Are those compensations enough to guarantee the adequate return over the invested capital, or they are just like partial compensation that you are able to get but still keep you below those return on invested capital targets? The last one is on European margins. Are they sustainable from the levels we saw in the first quarter, or are they reflecting a nonrecurring commercial negotiation adjustment from perhaps 2023 that are benefiting the metric for the quarter? Thank you.

Alberto Sada

Thank you, Andrés. Thanks for your questions. Let me start with the first one: As indicated, we have engaged ourselves in a series of initiatives to improve our operating performance overall, and those are within different aspects. On one side, as has been described at length, we are engaged with customer negotiations to pass on inflationary pressures. The other one, we're also working towards improving our cost structure so we have engaged ourselves in a very strong cost reduction initiative to try to offset part of this inflationary effect.

So with those two measures, plus the extension of the ICE business, which at the end translates into better use of the existing assets, lead us into a position to recover the margins that we have had before. Right now, we are operating at levels of close to \$13.7 per piece and eventually we should be aiming at levels of between \$15 and \$15.5 per piece. Certainly it's going to take a little bit of time but we're confident we're going to get in that direction.

Armando Tamez

Andrés, related to your second question related to volumes, our strategy with the customers we're pursuing and in which our customers are seeing lower sales in the electric vehicle, what we are doing is pursuing two elements, as I indicated in my remarks. The first one is a compensation for the underutilized capacity. That we're expecting to get a lump sum for the underutilized investment. In parallel, we need to adjust prices accordingly. If volumes are lower than the installed capacity, we are also negotiating a price increase to maintain our margins. This is something that we are confident that, based on that relationship that we have with our customers and the fact that we invested and they know, our customers, how much we invested. So we are confident that we will maintain our margins.

Alberto Sada

And Andrés, related to your third question on Europe, certainly, we're quite happy with the results that we have been able to achieve. You may have seen on a quarterly basis we have maintained similar level of margins in Europe and going forward we expect them to be at this levels. Certainly, the European business has been supported on one side with a good volume and product mix, but also on the other side through discussions and negotiations with our customers that lead us to adapt the pricing structure for the new cost reality. I expect those margins to continue at very similar levels for the remainder of the year.

Andrés Cardona

Thank you, Armando and Alberto. Congratulations for the first quarter results.

Alberto Sada

Yes. Thank you, Andrés.

Operator

Thank you. Our next question comes from Alfonso Salazar with Scotiabank. Please state your question.

Alfonso Salazar

Yes, thank you, and good day, everyone. The first question I have is regarding free cash flow generation. I just want to confirm that you still expect to have—to generate positive free cash flow for '24 and '25. And also, if you can provide, remind us what is the net-debt-to-EBITDA target for Nematik and where do you think it would be by year-end, by 2024 year-end? The second question, well, it's more a request than a question, but it has to do with long-term guidance that you provided back in 2021. It was very helpful to understand how Nematik expects these EV reduction costs to materialize in time, however the situation has been very different and has been struggling—is moving way more slowly than we anticipated back then. So just wondering if you can provide new guidance or prepared something that—an update of that guidance that you provided back in 2021, and maybe some comments on what has changed relative to the guidance that you provided back then today. Thank you.

Alberto Sada

Alfonso, let me start with the first question. Thanks for that. Related to the free cash flow generation, and as you indicated and we highlighted, we're expecting positive cash flow generation in both '24 and '25. In '24 it will be marginal and it will be driven by the actions that we have initiated on both the operating side as well as in the recovery of some of the negotiations we have with customers related to both unused capacity as well as inflation. So that should be way more positive in 2025 as we continue reducing our Capex levels given the pushout of the EV segment.

Your second question related to our leverage, the target for the end of the year should be somewhere around between the 2.5, 2.6 times net debt to EBITDA, and that's both a result of EBITDA growth that will help with that ratio, as well as the cash generation that should help us improve a little bit our debt as of the end of the year. So this should be a temporary spike and as we saw in this first quarter, slightly higher than last year we should be at similar levels in the next quarters, and then down at the end of the year as soon as elements materialize.

Armando Tamez

Alfonso, related to your question about the EV adoption. What we are seeing again is different dynamics in the market, and I think it's quite difficult to predict the penetration of the electric vehicles. Even our customers have are reviewing their business plans. What we have seen compared to 2021 is that, for instance, some of our customers were expecting that in North America the EV penetration will be up to 50%, and in Europe, about two thirds by 2030. Now our customers are basically addressing what the consumer is telling them, which there are, to some extent, not as keen to buy electric vehicles but to several factors. I think one is vehicles are more expensive, the charge is lower, infrastructure is not in every single country, and also the resale value of electric vehicles is lower than for the normal internal combustion engine.

Yes, we need to review our business plan and in the best time we will have again this business plan shared with all of you. I think as indicated, the market is volatile. On the other hand, I think it's very important to address the following points:

Nematik revenues today stands at 88% based on components for internal combustion engines. We have significant capacity to produce what the customers need in all regions, and I think we will take advantage

of that and certainly our customers today are telling us that the market penetration for electric vehicles, for instance, in North America, today's below 30%. And that is better, positive news for Nemak. And also in Europe, they're lowering, for instance, the expectations in terms of electric vehicles, and I think this is very positive for Nemak. That will give us an opportunity to use our existing assets, our existing technology to continue supporting all our customers worldwide with significantly less Capex. And that is very positive. I was actually disappointed that one of the rating agencies that saw this as a threat for Nemak. We see it to be positive. I think we need to educate some of the people that are following that, for us, we see positive news that the electrification is at a slower pace. That will give us an opportunity to improve our cash flow, reduce our debt, and certainly, be prepared once the market is ready for the electric vehicles.

Alfonso Salazar

Thank you. That is very useful.

Armando Tamez

Thank you.

Operator

(Operator Instructions)

Our next question comes from Alejandro Azar with GBM. Please state your question.

Alejandro Azar

Hi. Good morning, Armando, Alberto. Thank you for taking my questions. I have several ones, so if I may, can I take them one by one?

Alberto Sada

Go ahead.

Alejandro Azar

The first one is on your margins. If I heard correctly, you're targeting 15.5 per equivalent unit. Can you give us some color on the ramp up to those margins? I don't know, like building blocks, how much are you expecting from operating leverage? It's the bigger chunk to reach that on accounts to pricing? That would be my first one.

Alberto Sada

Sure, Alex. Thanks for the question. Certainly, there's a series of elements that take us to those levels of margins, and please recall that we use to have those margins just back a few years ago. There are several factors that we are addressing. As we have highlighted before, there are inflationary pressures that have, unfortunately, affected the results on our side, and they varied differently in different regions. Particularly in the North America case for Mexico, we have exchange rate effects, which, given the strong appreciation on the peso, that has taken a toll on our margins, which we're currently addressing with our customers related to pricing.

An important one to take us there is essentially to adopt the pricing structure, continue doing so for this new cost structure that we have, because some of our prices have economics dated from pre-pandemic levels that we need to fix. So we're confident that we'll be able to get to an agreement, long-term agreement with our customers so that we can secure production, particularly on the ICE side.

So then, we also have, as a Company, what we strive to be as efficient as we can and we look for efficiencies across our regions, particularly in North America as well. There we think we also have a little bit of room to maneuver. And last but not least, the mix. I think in general, we have good overall product portfolio that, even if it stays on the ICE side, will continue volume towards higher value-added type of products.

So I would say those are the three main elements. It's pricing, it's operating efficiency as well as mix that will drive margin improvements.

Alejandro Azar

Okay. Alberto, on your capacity utilization, is there any way that you can share how does it look on the powertrain side and on the EV side right now?

Alberto Sada

Well, on the EV side certainly, as we are seeing that the level of volatility in the market, certainly that's something that we're currently addressing with our customers on that side. We're about two thirds in capacity usage versus what we had estimated what we have. So there, we are essentially working through, and the customers, to try to recover part of those investments that are currently not being used, at least for the time for the industry to recover that launching pace.

Related to the traditional ICE components, there we have plenty of capacity. So, there, as you know, we have invested already for a long period of time, and that capacity obviously sits there for us to produce in case the ICE continues with the levels that we're seeing right now.

Alejandro Azar

Okay. And my last two questions would be on Capex and on your strategy on EVs. On Capex is, if I understand correctly, around \$100 million out of your \$400 million for this year should be allocated to EVs. Would the slowdown on the EVs, is that number going to change for this year, and how—is it fair to account in 2025 this number becomes zero and you probably only do maintenance on the EV side and the rest is powertrain? The other one is on the strategy regarding how you—is it changing how you approach the biddings for programs across EV platforms?

Armando Tamez

Thank you Alex, I will try to respond to your question. First, I think when we are talking about EVs, we are talking also about chassis components as well as structural components. As we indicated, most of the parts that we are producing with the exception, for instance, of battery trays are propulsion agnostic components. Those parts could go on vehicles of that internal combustion engines, hybrids or electric. So I think what we are seeing right now from different customers is that they are switching back to ICEs and hybrids. Those are products that are in high demand today, both in North America and in Europe. So in that regard, I think, we produce our assets better and investments.

We continue to be very sensitive to, again, our Capex. We are, again, trying to limit this year to less than \$400 million in total Capex. And certainly, we will take a closer look. One of the things that we are doing

today is that we're asking most of our customers to help us with some of the investments. If they want us to produce some of the parts, we're asking them to contribute and we have been, so far, successful with some customers. And we will continue with that to reduce our risk, again, with this volatility on the lease side.

Alejandro Azar

Okay. And regarding the approach on the bidding of programs, with the slowdown that you're seeing, is that changing?

Armando Tamez

What we are seeing is, again, some of the customers now, they realize that the EVs are not selling to the level that they were expecting. You can see, and this is public information, most of the OEMs have reduced their expectations and now they are talking about increasing their capacity for internal combustion and hybrids. And certainly, we are watching this very closely and being very conservative in terms of what is the products and the customers in which we are going to invest. And certainly, as part of our negotiation we're asking also for price sensitivity related to volume. So in the event that the volume doesn't materialize that customers need to adjust prices.

Alejandro Azar

Okay. Thank you. Thank you both.

Armando Tamez

Thank you, Alex.

Operator

Thank you. There are no further questions over the phone at this time. I'd like to turn the conference back over to Ms. Reyes to address the questions placed via web.

Denise Reyes

Thank you, Operator. We'll now move on to the questions from the web.

The first question is from Marcelo Motta from JP Morgan. Could you please provide more details on how much the underutilized capacity in the EV/SC segment could impact margins in the next quarter?

Armando Tamez

Thank you, Marcelo. I think we have already answered that but I'm going to repeat it. Certainly, as we indicated, we have already presented claims for the customer that we see volumes below the capacity installed. That's the first part. Second, we need the price adjustment as well to compensate for this volume drop. In addition, Marcelo, and we mentioned already this, we have implemented a significant cost reduction initiatives in the Company at a global level. So we are looking for further efficiencies in every single plant and also reducing our cost, and we are again, with the entire Management Team, focusing on improving performance and efficiencies. And in summary, we're convinced and committed not only to meet or try to surpass our guidance.

Denise Reyes

Thank you, Armando. There is a second question from Marcelo Motta. Was there any impact in first quarter margins given the significant increase on a year-over-year basis?

Alberto Sada

Well, on the margins, as we have highlighted, (inaudible) I am confident that this level of margins going forward. So there's a combination of different elements. As we saw, there were lower volumes, but at the same time we have very good performance in Europe, which is, on average, pushing our margins. So that increase in margins in Europe will be sustainable. That has a combination of commercial activities, better mix, as well as efficiencies, a little bit of exchange rate as well.

So I would say that in combination this is a fairly recurrent group of results. There's, again, a combination. A few one-times here and there but we expect any of those happening all along the year.

Denise Reyes

Thank you, Alberto. The next question is from Peter Bowley from Bank of America. Thank you for the call. On the large year-on-year EBITDA growth in Europe, can you share roughly what percentage of each factor accounted for the growth? You mentioned the factors of product mix, lower energy, commercial negotiations. How sustainable are those \$17 per equivalent unit margins for Europe?

Alberto Sada

Yes, as we have already shared, we feel confident to sustain those level of margins all along the year in Europe, and those are a combination of those three elements. Unfortunately, given the confidentiality on the commercial negotiation side, we cannot share too much details, but certainly all of the above play a role in sustaining that result.

Denise Reyes

Thank you, Alberto. Now we have a question from Iñigo Cossio from Kapitalia. It reads: can you give us more color on the expected time to achieve the two times net-debt-to-EBITDA target? We have seen weak results in the North American market during the last couple of quarters. What is your outlook for the rest of the year for this market?

Armando Tamez

Yes. Thank you, Iñigo. Yes, we are targeting internally is to go back to this two times leverage that we achieved seven years in a row before the pandemic. Certainly, we have full commitment from the entire team to go back to these levels. We're expecting that we could reach the two times leverage in approximately between 18 to 24 months.

Denise Reyes

Thank you, Armando. Now we have a question shared by Marcelo Motta from JP Morgan and Ariel Grignafini from Fintech Advisory. The question is related to the North American volumes during the first quarter since they were down 12% year-over-year versus the IHS expectation of 1.4 year-over-year?

Alberto Sada

Well certainly the North American volumes, talking on the Nemak side, have been affected by the reduction on the EV component side. Those were expected to add, contribute to our volume growth in North America, but I have all along indicated during the call, those volumes are unfortunately lower. So that has an effect translates into a little bit of erosion of market share from our customers.

Denise Reyes

Thank you, Alberto. The next question is from Agustin Bonasora from PineBridge. Could you please explain how we should think about the volume dynamic in Europe and the U.S., considering that Nemak's client production dropped in Europe but Nemak's volume increased in these regions and vice versa in the U.S.? Should we see lower volumes in Europe and higher in the U.S. going forward?

Alberto Sada

On the volume side, and again, this is totally fluent given how the expectations are materializing on the EV front, but I think we should be seeing a similar behavior during the rest of the year, mainly a little bit of a recovery in the North American side, and I would say that we should be seeing stability on the European side. But I would say that the dynamic all in all moves in the direction that we're seeing the industry behave. When you see differences in a particular quarter, sometimes it has to do with inventory rebalances or some changes, talking about production, some changes in the production schedules particular to any particular customer.

So we should be seeing a mix but I think all in all the industry is well supported on the sales side, and that should continue to drive production.

Denise Reyes

Thank you. Now we have a question from Carlos Manuel Santiago from BBVA Mexico. Which specific actions are you taking to mitigate what the rating agencies are observing in the last month?

Armando Tamez

Basically, we are having an open conversation with all the rating agencies every quarter and sometimes even more frequently. Basically, what we are trying to do is deleverage in the Company. We are reducing our Capex, trying to improve our performance so that we can improve our EBITDA, as well as with some of the claims that we have related to inflation, related to under capacity utilization. And we truly believe that once we start getting the support from customers, plus the cost measures we are taking, that we will improve our topline and also reduce our debt. We're planning to generate cash flow this year and the following.

Denise Reyes

Thank you, Armando. The next question is from Carolina Heyermann from LarrainVial. Why did the cash and cash equivalents decrease this quarter and also why did your cost of goods sold decrease?

Alberto Sada

Yes. As highlighted on the earlier part of the call, the working capital cycle requires investments in the first and second quarter, and that essentially is what drove the decrease in cash. So that explains the increasing debt. And what was the second part of the question?

Denise Reyes

The cost of goods sold

Alberto Sada

The cost of goods sold, as you know, a big portion of our cost has to do with aluminum and there has been price movements on aluminum on the down side, so whenever we see that reduction, will immediately translate it to lower cost of goods sold, and at the same time lower revenues. As you know, this is a pass through to our customers.

Denise Reyes

Thank you, Alberto. We have one last question on the web from Emilio Fuentes from GBM. Hello. You mentioned the possibility of divesting assets that do not meet the threshold of returns established. Could you give more color on said thresholds and other metrics for evaluating divestitures?

Armando Tamez

Yes. Thank you, Emilio. Good question. And yes, we are evaluating as we speak some of our plans that are not getting the right returns on invested capital, and we have serious conversations with our customers that in some instances is that we have not been able to recover inflation, especially on the labor side. And we're very serious. If we are not able to convince some of the customers to help us, we will divest some of these plants. At this point in time, we cannot give you any color in what are the plans, but our customer are aware of where these facilities are located. We need to have solid performance in all our plants. We are not prepared to subsidize any single customer, and we are determined to improve the financial performance of the Company. That's a commitment and we will make sure that we deliver.

Denise Reyes

Thank you, Armando. We have received another question via telephone, so we will move to that one.

Operator

Thank you. We have a follow up question from Alejandro Azar with GBM. Please state your question.

Alejandro Azar

Thank you, Denise, for bringing me back. Just one more question for Alberto and Armando, taking advantage of your time. We've seen in the past five years, a little bit more on that, your clients losing market share. What is Nematik doing internally to capture new clients, let's say, (inaudible) Chinese OEMs or Toyota, Honda? Are you seeing, let's say, these new OEMs interested—or especially Toyota, interested in your chassis applications, because I understand they do their own internal combustion engines, but what color can you share on that front?

Armando Tamez

Yes. Alex as we speak, we have already Chinese customers and Japanese customers as well. Toyota is one of them, is our customer, and very good customer, by the way. Certainly, we are open and in discussions with Chinese OEMs. We have had already visitors looking at some of our facilities in different regions. And we're totally open. As I indicated, they have attractive products. They have also good prices that are attractive to the general public, and we are doing our commercial efforts with all OEMs. We are, again, looking for opportunities. I think, as you're indicating, on the chassis side, on the EV as well, we have

opportunities and certainly we will continue doing our commercial efforts to get different customers in addition to what we have today in our customer portfolio.

Denise Reyes

Thank you, Armando. There are no further questions at this time. With that, we conclude today's event. I would just like to take this opportunity to thank everyone for participating. Please do not hesitate to contact us if you have any follow up questions or comments. Have a good day.

Operator

Ladies and gentlemen, this does conclude today's earnings webcast. Thank you for your participation. You may disconnect your lines at this time and have a wonderful day.