



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

Second Quarter 2022 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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P R E S E N T A T I O N

Operator

Good morning, everyone, and welcome to Nemak's Second Quarter 2022 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 will now turn the call over to Adrian Althoff.

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 will open up 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. 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 over the call to Armando Tamez.

Armando Tamez

Thank you, Adrian. Hello, everyone, and welcome to Nemak's Second Quarter 2022 Earnings Webcast.

During the quarter, we saw an overall positive trend on the demand side, as new product launches and increased customer production supported higher volume amidst a partial lifting of semiconductor supply constraints in our industry. At the same time, we took steps to address extraordinary inflationary pressures, including higher energy, raw materials, labor and transportation costs. We're making progress with commercial negotiations aimed at mitigating such affects on our results.

At the consolidated level, higher volume and aluminum prices dropped (phon) a 25% top line improvement on a year-over-year basis. However, the inflation related dynamics I just described caused EBITDA to finish slightly lower. Our second quarter results reflected the implementation of measures developed in tandem with certain customers to offset inflationary pressures on our business retroactive to January 1 of this year. I would also like to emphasize that we continue to work towards finalizing similar agreements with the rest of the customer base and aim to conclude these negotiations in the third quarter.

Meanwhile, on the operations side, we've maintained a prudent approach to financial management, with a focus on keeping our cost structure lean and optimizing cash flow generation, while supporting customer requirements linked to (inaudible) recover, as well as secular shifts towards vehicle electrification. These efforts help us to reduce leverage from 2.5 to 2.3 times on a sequential basis.

In the recent developments, and as you may have already heard, Fitch and Moody's recently affirmed the rating on Nemak's credit profile while maintaining the respective stable outlooks, citing the Company's leading market position, geological diversification and confidence in the Company's ability to successfully navigate the automotive industry transition to electrification, while delivering improved earnings and reducing leverage, among other factors.

Moving on to strategy and implementation. I am pleased to share that for the quarter, we won contracts (inaudible) worth a total of approximately 240 million annually, 95% of (inaudible) incremental business.

Regarding our E-mobility and structural application segment, we won new business for approximately 130 million annually, bringing our order book dispatch (phon) to approximately 1.53 billion annually, as we continue to advance faster than expected towards our '25 target of 2 billion. Additionally, we were awarded contracts to produce ICE powertrain components for approximately 110 million annually across our regions.

Overall, the business for the quarter centers on the adaptation of existing capacity to meet customer requirements. In particular, I would like to emphasize our progress towards harnessing (phon) processes and technology that we have traditionally used for ICE applications now to deliver higher value-added solutions for electric vehicles.

The main highlights include contracts to produce structural parts in North America and Europe for fully electric SUVs of premium OEM customers, along with complex e-motor housings for SUV applications of

a leading global manufacturer of fully electric vehicles, representing our first awarded business with this customer today in Europe.

All together, these awarded businesses for EVs represent an important milestone in our efforts to deliver on our target for growth and transformation in our business through 2030.

Moreover, we continue to pursue a robust pipeline of potential new opportunities focused on EVs, which currently comprises potential business for a total of more than 1.6 billion annually across a variety of highly engineered applications, including battery housings, e-motor housings and structural parts, among others.

Before I conclude, I would like to touch upon our recent step forward in our efforts to advance our ESG performance, reflecting our accountability and our commitment to contribute to the conservation of the environment and the well-being of society.

I am very pleased today to announce that we have joined the Aluminum Stewardship Initiative. By implementing a sustainability performance standard, we will comply to the rigorous set of requirements assuring the responsible production, sourcing and stewardship of aluminum. In addition, this reinforces our greenhouse gas emission reduction pathway as the standard aggressive GHG emissions and entails public disclosures of related data as critical components of transparency. Through our membership in the Aluminum Stewardship Initiative, we not only demonstrate our leadership in key sustainability issues within the Aluminum supply chain, but we also contribute to the global effort to drive positive change through collective actions.

With that, I will now hand off the call to Alberto, Nemak's CFO.

Alberto Sada

Thank you, Armando. Good morning, everyone.

First, I would like to provide a recap of Nemak's financial performance and industry trends in the quarter.

During the second quarter, our top line showed improvement versus the same period last year, mainly on the combination of higher aluminum—higher volume and aluminum prices. At the same time, in response to continued inflationary pressures, we implemented agreements with customers, which enable us to offset a portion of these effects, and therefore improve our business performance on a sequential basis.

We continue to see signs of industry recovery amidst ongoing supply chain issues, including semiconductor shortages, although trends varied by region. North America showed relative strength with light vehicle production finishing up 12% in the quarter; whereas in Europe, light vehicle production was nearly flat year-over-year as OEMs implemented workarounds in response to supply disruptions in the region linked to the war in Ukraine, particularly in wire harnesses. Meanwhile, China was down 16% in the quarter, reflecting that country's zero COVID policy and enforced lockdowns; whereas Brazil saw a 9% increase, as supply chain conditions improved versus the same period of last year.

Light vehicle sales trended softer than light vehicle production across the board, as historically low inventory levels largely attributable to the effects of the global semiconductor shortage, continue to weigh on vehicle availability. At the same time, based on our consultations with customers and industry experts, we continue to see significant pent-up demand in key regions. For instance, U.S. inventory levels remained low, with June marking the eight straight month that retail inventory closed around the 1 million vehicle mark. While in Europe, waiting times for new vehicles remain high by historical standards, generally ranging between eight months and a full year.

In conclusion, we continue to see vehicle availability as the main driver of sales, with no sign of any material let-up on the demand side despite rising interest rates and evidence of softening general economic conditions.

Moving on to our business performance. Volume was 9.8 million equivalent units, 10% higher year-over-year, due mainly to the combined effects of higher customer production in certain regions, as I just described, together with continued contributions of new product launches globally. In turn, revenue benefited mainly from higher volume and aluminum prices, finishing at 1.2 billion, or 25% higher than a year ago.

In terms of top line drivers, I would like to emphasize that we are pleased with the progress we're making in ramping up our new segment focused on e-mobility and structural applications, which we continue to expect to generate around \$470 million in revenue for the full year 2022.

EBITDA in the second quarter was \$149 million, as higher volume, commercial negotiations and cost efficiencies nearly offset the impact of the inflationary environment on our cost structure. Additionally, we experienced a negative translation effect resulting from the depreciation of the euro against the U.S. dollar.

Regarding commercial negotiations, we made progress towards implementing agreements aimed at mitigating the inflationary effects on our business performance. As a result of these efforts, we concluded negotiations with customers, representing approximately 50% of our consolidated revenue retroactive to January 1, 2022. Keep in mind that negotiations are still ongoing, and we believe that we remain well positioned to complete negotiations across our customer base in the third quarter. Additionally, I would like to emphasize that following the completion of these negotiations, we expect that we'll be able to deliver an EBITDA unitary margin at guidance or higher.

During the period, we also continued to deploy a variety of initiatives to optimize costs, expenses and cash flow generation, which help us to keep strict control of our cost structure amidst these challenging market conditions.

Operating income in the quarter was \$74 million, reflecting the same factors that affected EBITDA. This figure compares to the \$69 million reported in the same period of last year.

Net income was \$30 million compared to the \$44 million reported in the second quarter of 2021. This result was mainly related to the same factors affecting operating income, together with the accounting effects of the depreciation of the euro against the U.S. dollar and higher income taxes.

In keeping with our ongoing efforts to support value creation, we continue to implement a prudent financial management strategy, prioritizing capital allocation towards strategic projects linked to vehicle electrification, along with deleverage.

On the capex side, we recorded investments of \$92 million, 28% higher than in the same period of last year as we continue to direct investments mainly towards new product launches with a focus on our e-mobility and structural application segment.

As of the end of June, net debt was \$1.2 billion, 7% lower than at the end of March 2022, following the reduction of short-term bank debt and exchange rate effects. Net debt to EBITDA and interest coverage ratios were 2.3 times and 5.1 times, respectively, lower and higher compared to the end of the first quarter, respectively.

Excluding recognizing costs associated with our bonds issued last year, our interest coverage ratio was 6.7 times.

Moving on to the regional results in the quarter. North America volume as 5.3 million equivalent units, 18% higher year-over-year, supported by customer light vehicle production, along with contributions of new product launches on our side. Revenue, in turn, was \$663 million, 44% higher than in the same period of last year, propelled by the higher volumes I just mentioned, together with aluminum prices. EBITDA was \$84 million, which compares to US\$74 million a year ago as commercial negotiations helped us to more than offset inflation related effects in the region

Europe volume was 3.4 million equivalent units, slightly higher year-over-year, as new product launches more than compensated for effects of supply chain constraints and customer light vehicle production. Revenue was \$394 million, 3% higher than the \$381 million reported in the same period of last year, as volume and aluminum prices more than compensated for effects of the depreciation of the euro against the U.S. dollar. EBITDA was \$57 million, 70% lower than a year ago, as compensation from customers partly offset effects of inflationary pressures.

Rest of the world volume was \$1.2 million equivalent units, 5% higher year-over-year, as improved volume in Brazil more than compensated for softer volumes in China. Revenue during the quarter was \$140 million, an increase of 25%, which was mainly due to volume and aluminum prices. EBITDA was \$8 million, close to the same level of last year.

Thank you for your attention. This concludes my presentation. I will now turn the call back over to Adrian to open up the Q&A session.

Adrian Althoff

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

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

Alfonso Salazar

Thank you, everyone. Can you hear me?

Alberto Sada

Yes.

Armando Tamez

Yes.

Alfonso Salazar

Okay, thank you. I have two questions and the first one has to do with these signs of recovery and the pent-up demand that you talked about. The question that I have is, if it cannot revert, especially the signs of recovery because of the high inflation, the higher interest rates, the fact that cars are becoming extremely expensive for many buyers and disposable income is going to be affected by all these situations, especially I'm thinking in the U.S. that's supposed to be resilient during the quarter, so just wondering if you think that at some point of what you hear from the OEMs about the fact that pent-up demand, which is expected after so many years of very low sales, if at some point this could be negatively impacted by the situation that we are facing, something that it would be interesting to hear what you have to say about that.

The second question that I had is regarding the situation in Europe. As you know, the Nord Stream 1 is closed now and is expected to reopen in July 21; however there are some valid concerns that it won't happen. So, just wondering if you can tell us what are the implications if that is the case, and how Nemak would need to adjust production thinking that aluminum production, chemical production and certainly automotive production would be—could be severely impacted if that was the case.

So, those are the two questions that I have.

Armando Tamez

Thank you. Thank you Alfonso. Certainly, we are seeing all over the world higher inflation, as you are indicating also, higher interest rates, and perhaps also a reduction in disposable income. Having said all that, what we are seeing, Alfonso, is that pent-up demand is there. Also another element that we need to consider is, for instance, the availability of vehicles. Today the inventory levels are at the lowest point in the last 35 years. The inventory level today, to our knowledge, in (inaudible) North America, is approximately 24 days. The normal inventory level that customers supply to keep before the pandemic was in the range of 80 to 85 days. We have seen also increases in used cars because of lack of availability of new models or new vehicles and that was actually the combination of both elements: first, COVID and second the shortage of semiconductors.

As we're indicating in our presentation, we are seeing, let's say, a better perspective in terms of availability of semiconductors still not 100% solved by our customers. But, we are seeing that the market is there. The automotive park in the U.S. today is approximately getting at 12 year old vehicles, so people are again getting tired of having to keep maintenance on the vehicles. So, we still believe, and this is consultation with customers as well as analysts, that the demand will be there even if a potential recession comes. We are not indicating that the volumes will go to 18 million units as it was in 1980—2018, but we believe that volumes will remain strong in North America.

In Europe, as everybody knows, the conflict between Russia and Ukraine is unfortunately affecting as well the supply chain as well as the inflation. But we believe that also there is pent-up demand in Europe that will maintain volumes as we are putting in our guideline.

The second question, Alfonso, you are absolutely right. The Russians, they're providing maintenance to the gas pipeline. That is, to our understanding, a normal maintenance procedure. We are not aware that they will not restart, for instance, selling or supplying gas to some of the European nations that have already (phon) contracts, and I think it would be too early for us to tell what would be the implications in the event that they will not, let's say, put back this pipeline. But certainly we will take the necessary actions in the event that something like that happens. But we have not seen it in the past.

Alfonso Salazar

Okay. So, just to clarify, in the case of pent-up demand, even if it was going to be as strong as it probably was at the beginning, in the case that inflation and car prices and financial cost to finance the car purchase increase, even if that is the case, you continue to see pent-up demand going forward.

Armando Tamez

Yes. We are seeing a strong demand. Actually, Alfonso, just for the record. We are expecting to finish approximately a little bit less than 1 million national (phon) units in this calendar year over our original guidance in terms of volume. So we are seeing, let's say, respectable volumes for the rest of the year.

That is something that we could also say. In the event that, for instance, our customers start seeing a recession, I think they will need to go back to some extent to offer incentives and lower prices. I think customers have taken advantage of the scarcity of new vehicles, and they have eliminated all discounts and even they have been increasing prices. So, we believe that it's a matter of time in which customers - if they see that the demand for new vehicles is going down - that they will start providing certain incentives so as to maintain at least certain volumes.

Alfonso Salazar

Okay, fair enough. Thank you for the answers.

Armando Tamez

Thank you.

Operator

Our next question comes from the line of John Hau (phon) with Mizuho. You may proceed with your question.

John Hau

Hey. Good morning guys. Thank you again for the call. Just to kind of back up for one second; you mentioned you're going to be able to maintain EBITDA guidance and even exceed it for this year. Can you just—I got on late and I just wanted to hear those comments once more, if you could, please? My other question was answered already. Thanks.

Armando Tamez

Yes, for sure, John. What we were saying is that, as we explained on the previous comments, that with the current negotiations of the inflation adjustments with our customers, what we have done so far and where we're planning to conclude in the next few weeks, we should be able not only to maintain but exceed our unitary EBITDA for the year. If you'll recall, the unitary EBITDA guidance is \$13.6 per equivalent unit. We feel confident that with these negotiations, together with the volume performance as well as the cost improvements that we're showing, we should be able to not only meet but maybe slightly exceed this unitary EBITDA.

John Hau

Okay, and at the moment there's no other changes to your guidance for this year that you announced earlier.

Armando Tamez

Yes.

John Hau

Okay. Do you foresee anything that might, at least at this point, might weigh on that or decision?

Alberto Sada

Well, no. No, I think—I mean, we're sticking with our guidance so far. I think Armando highlighted from volume side we're seeing fairly good performance. So, we're confident to meet or even slightly exceed the guidance.

John Hau

Okay. Thank you very much.

Armando Tamez

Yes, and in addition to that, we are confident that we're making very good progress in our negotiations with our customers to adjust for inflation. I think we will have, over the next few weeks, a resolution with most of our customers.

John Hau

Will you announce that to the market?

Armando Tamez

Sorry, can you repeat that?

John Hau

Would there be more of a formal announcements on the market when you do have those—complete those negotiations?

Armando Tamez

No. Those, I think, are confidential negotiations and...

John Hau

Okay.

Armando Tamez

... information that we will provide internally, but certainly we're expecting to have a fairly strong third quarter.

John Hau

Thank you very much.

Armando Tamez

Okay.

Operator

Our next question comes from the line of Christian Aust with Bernstein Automotive (phon). You may proceed with your question.

Christian Aust

Yes, hi. Good morning. Quick question on again on the guidance and your comment that you have contracts in place for U.S. customers for 50% of the annual sales. Just maybe you can elaborate a little bit on the target for the full year? So, you want to have contracts or negotiations completed for with all customers and would that cover 100% of the cost or is there a different number, for example, 70% of the input cost inflation and the remainder (phon) coming from internal measures? That would be my first question.

Alberto Sada

Yes, well, Christian, certainly what we are asking for our customers as much as we can and at the end it's going to be a combination of what we are able to obtain from the customers as inflation adjustments and our cost reduction initiatives. So, we're quite confident that we should be able to contain a large portion of these effects.

Christian Aust

Okay, but you cannot give a number in terms of roughly what the split would be?

Alberto Sada

No, I'm sorry, but not at this point. Remember, that we're still in negotiations with certain customers so we need to keep that information.

Christian Aust

Okay. Okay. Thank you. The second one would be on your bonds. I'm looking at the cash balance. It looks quite decent. The bonds are trading in the low 70s. Any considerations of maybe buying some of that back?

Alberto Sada

Yes, for sure. We have gotten that question multiple times, but what we are favoring right now is really the investment in our projects, in our investment contracts that we have. As you know we have been quite successful in obtaining the business. We want to make sure that we're redirecting our cash flow towards our capital expenditures that we need and ultimately to reduce the leverage as well.

So, no intentions at this point to (inaudible).

Christian Aust

Okay. Thanks.

Adrian Althoff

Thank you Operator. We will now move on to questions from the web. We have a question from Lisha Zach (phon) from GBM. Lisha asks: "Do you mind repeating the EBITDA per unit that you expect?"

Alberto Sada

Well, as we highlighted just a few questions ago, we believe that we'll be able to meet or exceed our \$13.6 per unit, per equivalent unit of EBITDA for the full year. So, that was our guidance. We have certain assumptions into that. We believe that we're well positioned to meet that or even slightly exceed it.

Adrian Althoff

The next question comes from Jacob Steinfeld from Ashmore. Jacob asks: "Can you quantify the positive impact in second quarter from the retroactive adjustments from first quarter applied in second quarter? Which percent of your customers have you been able to pass through the cost increases and by what percent?"

Alberto Sada

Well, as we discussed, we have been able to successfully conclude those negotiations with approximately 50% of our revenue, the customer represented in terms of 50% of our revenue. And yes, there is part of what we gained this quarter was associated with the first quarter. But if you do the math and if you do the addition of both first and second quarter, that will give you an idea of what that total effect would be. To that effect, we're still missing the negotiations of the remaining 50%. So, that's going to help us take us to that \$13.6 or a little bit higher of EBITDA per unit for the end of the year.

Adrian Althoff

The next question comes from Antonio Gomes from Ninety One. The question is, "Is the semiconductor shortage impacting volumes? Your volumes increased throughout the year-over-year despite weak sales volumes. Is this the case of production coming ahead of sales volumes in the auto market?"

Armando Tamez

Yes, thank you. Thanks for the question. Certainly, what we are seeing as it was already presented, we saw, due to the conflict in Europe between Russia and the Ukraine, there was some interruption in the supply chain and our customers moved some of the semiconductors that they were using in Europe to North America and that helped production in North America. Now it's a little bit more stable.

What we are seeing is that, as I indicated, that our customers are certainly improving significantly the availability of semiconductors. And yes, we believe that they will continue working where their key suppliers trying to get additional capacity to solve once and for all the shortage of semiconductors.

Adrian Althoff

Okay. The next question comes from Allan Miranda (phon) from Red Intelligence. "According to media reports, there is a shortage of aluminum for the beverage industry. Does this affect the automotive industry including Nemak or do you expect it will?"

Alberto Sada

Yes, thank you, Allan, for that question. At this point we're not seeing any effect on the availability of aluminum. Remember that a large portion of what we procure is secondary aluminum, so it's already on the scrap market. So, we haven't seen yet any effect of availability of aluminum for any of our operations.

Adrian Althoff

Okay. The next question comes from Andres Cardona from Citi. He says: "It seems there was a reallocation of raw materials from Europe into North America. Do you expect it to remain the case in the second half of 2022?"

Alberto Sada

Any material flow from Europe to North America?

Adrian Althoff

Maybe in terms of the semiconductors. Maybe. If there was semiconductor availability in North America.

Armando Tamez

Yes, as I indicated, we saw that our customers, again, had this disruption due to the conflict in Europe and they moved some of the semiconductors to North America to start building more vehicles and increase, let's say, the offering in this region. We are now seeing more stabilization in terms of the European operations and we're seeing more stabilization in both regions.

Adrian Althoff

Okay. Also the next part of this question: "Do you see the equivalent of 50% of revenues renegotiated to recognize the inflation costs?" So just to confirm that.

Armando Tamez

Yes. Yes, as highlighted, we have reached agreement on approximately 50% of the revenue with such customers.

Adrian Althoff

He also asked if you can provide color on the working capital outlook for the full year.

Alberto Sada

Well, yes, we will continue focusing ourselves to improving as much as we can our working capital. As you may have seen, that was—we continue to have a good performance on that front. So, we expect to potentially increase it a little bit in the third quarter but ultimately reduce it at the end of the year due to the regular cycle of our business.

Adrian Althoff

Okay. 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 feel free to contact us if you have any follow-up questions or comments. Have a good day.

Alberto Sada

Thank you.

Operator

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