



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

First Quarter 2023 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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P R E S E N T A T I O N

Operator

Good morning everyone and welcome to Nemak's First Quarter 2023 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 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 because of new information, future events or otherwise.

I will now turn the call over to Armando Tamez.

Armando Tamez

Thank you, Adrian. Hello everyone and welcome to Nemak's First Quarter 2023 Earnings webcast.

During the quarter, we saw positive top-line trend, as new product launches and increased customer production supported higher volume amidst a continued easing of semiconductor supply constraints in our industry. We also made progress in ongoing efforts to address extraordinary inflationary pressures, advancing the negotiations with customers aimed at mitigating impacts to our results.

All together, volume drove an 11% top-line improvement on a year-over-year basis, whereas EBITDA was 15% higher, as volume and an improved product mix partially offset the impacts of inflation.

Turning to strategy execution, we made further strides in ramping up production of parts for electric vehicles in the quarter, advancing with setup of new facilities to produce battery housings in Mexico, Germany, and the Czech Republic. We initiated test production at the facility in Mexico, keeping us on track to reach series production at this location later this year. We also continue ordering and setting up production equipment at the new facilities in Germany and the Czech Republic, where we expect to launch series production in the second half of 2023 and 2024, respectively.

At the same time, we continue to invest in expanding production for recently awarded business in battery housings for fully electric vehicles of OEM customers at our Electric Mobility Center in Mexico. Since its launch in 2020, we have grown this facility into a regional hub for the manufacture of these parts, leveraging our talent and expertise in design engineering as well as leading-edge joining and assembly processes, such as laser-hybrid welding and friction stir welding, among others, to support our customers' electrification and lightweighting needs.

Moving on to the sales and marketing side. The main highlight from the quarter was awarded business to produce complex housings for fully electric vehicles of a European customer. This business amounts to approximately \$30 million annually, and brings our order book in e-mobility, structure and chassis applications segment to approximately \$1.63 billion annually. Moreover, we remain focused on accelerating our growth in the electric vehicle market, pursuing a pipeline of potential new opportunities worth more than \$1.5 billion annually across our e-mobility, structure and chassis product lines.

I would also like to touch on highlights in the implementation of our sustainability agenda.

In recognition of our ongoing efforts to actively engage with suppliers to manage climate change, we were awarded the CDP's Top Supplier Engagement Rating of "A". With this rating, Nemak remains part of the CDP's Supplier Engagement Leaderboard, which includes companies that are pioneers in driving the transformation of their business towards a zero emission future. To give an idea of the significance of this recognition, only 8% of the companies that report to the CDP are on the Leaderboard.

Nemak was also the recipient of a couple of awards in the first quarter of 2023, which I would like to briefly tell you about.

First, we received the Excellent Supplier Award from Changan Ford in China, which is the highest level of recognition given by customer to Tier 1 suppliers for providing top quality, customer service, delivery, solutions, new program launches and commercial support.

We also won the "Outstanding Employer 2023" Award in China from 51job, a leading human resources service provider. Nemak was part of a select group of companies chosen for its excellence in attracting and

retaining talent, digital transformation, personal development, and the Company's commitment to its sustainability goals.

With that, I conclude my remarks, and will now hand off the call to Alberto.

Alberto Sada

Thank you, Armando, and good morning everyone.

I will guide you through a quick recap of industry trends during the quarter, followed by a summary of our financial results.

Our results were positive overall, both on a sequential and year-over-year basis, on the back of better volumes driven by improved industry conditions in our main regions and new product launches, particularly in the e-mobility, structure and chassis segments, along with a richer product mix. At the same time, we continue negotiating inflation pass-thru agreements with our customers, particularly addressing labor and other inflationary pressures, which were not part of our negotiations last year, and which account for most of our margin gap versus our historical average.

The automotive industry showed signs of recovery due mainly to the continued easing of supply chain conditions, particularly in semiconductors. As a result, in the quarter, light vehicle production in North America showed a 6% growth year-over-year, while production in Europe increased by 12%, reflecting the same drivers. Brazil was up 5% in the quarter compared to the same period of last year, while China decreased by 9% due mainly to lingering effects of the COVID-related shutdowns at the beginning of the quarter.

Turning to our financial results. Volume was 10.8 million equivalent units, 8% higher year-over-year on the back of higher customer production and new product launches across our regions, particularly in our e-mobility, structure and chassis applications.

Moving to revenues. Higher volume and better product mix drove an 11% year-over-year increase to \$1.3 billion. On a sequential basis, revenue finished 12% higher versus last quarter due to the same factors.

During the first quarter, EBITDA was \$132 million, 15% higher versus the same period last year, mainly due to higher volume and better mix, supported by increased production of e-mobility, structure and chassis applications. This enabled us to partially offset effects of inflation. Our EBITDA per unit, in turn, showed a 6% year-over-year increase to \$12.3 per equivalent unit.

As mentioned previously, we continue to work in tandem with our customers to address inflationary impacts, with the aim of implementing measures with retroactive effect to January 1 of this year.

Operating income in the quarter was \$49 million, following the same dynamics that propelled EBITDA. This figure compares to the \$35 million reported in the same period of last year. The net result in the quarter was a \$15 million loss, mainly influenced by a non-cash foreign exchange loss of \$26 million associated with the accounting effect of the depreciation of the U.S. dollar against other currencies, as well as the effect higher interest expenses associated with higher reference rates. This compares to the \$6 million in net income reported in the same period of 2022.

Shifting gears to recent developments, we have started reporting our financial information in U.S. dollars, replacing the Mexican peso as a reporting currency since January 1 of this year, and therefore, aligning our financial reporting with our functional currency. This change was made in accordance with international accounting standards.

Turning to capital allocation. We continue to prioritize the strategic investments focused on the electric vehicle market. To this end, we remain selective in the pursuit of new business, with a goal of driving profitable growth.

During the quarter, we invested \$121 million, 34% higher than in the same period of last year. These funds were directed primarily to the new product launches in our e-mobility, structure and chassis segment.

During the quarter, working capital increased sequentially by \$112 million, mainly due to the seasonal effects and the normalization following last quarter's reduction. As mentioned in our last earnings webcast, we had an atypical benefit in working capital on the receivables side at the end of the year.

As of the end of March, net debt was \$1.4 billion, 15% higher versus year-end 2022, due to the working capital factors just mentioned. Net-debt-to-EBITDA and interest coverage ratios were 2.5 times and 7.5 times, respectively, versus 2.3 and 7.9 times in December of 2022.

Moving on now to regional results.

During the quarter, North America volume was 5.9 million equivalent units, 12% higher year-over-year, supported by higher light vehicle production and new product launches in our e-mobility, structure and chassis applications segment. Revenue was \$696 million, 16% higher than in the first quarter of '22 on the back of higher volumes. In turn, EBITDA was \$74 million, 8% higher versus last year, mainly due to higher volume and an improved product mix, which helped us to partially offset inflation-related effects in the region.

Volume in Europe was 3.6 million equivalent units, 5% higher year-over-year, due mainly to higher light vehicle production and new product launches in the new segment. Revenue was \$426 million, 9% higher than the \$390 million reported in the same period of last year, as higher volumes outweighed the effects of the euro's depreciation against the U.S. dollar. EBITDA was \$43 million, 5% higher than a year ago, in line with volume, which, together with product mix, partly offset inflation-related impacts.

Rest of the World volume was 1.2 million equivalent units, 2% higher than last year. Revenue during the quarter was \$135 million, a 3% decrease, mainly related to exchange rate fluctuations. EBITDA was \$16 million, 131% higher than in the same period of last year, driven largely by product mix and operating efficiencies in the region.

This concludes my presentation. I will now turn the call back to Adrian to open up the Q&A session.

Adrian Althoff

Thank you, Alberto. We're 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

Thank you. (Operator Instructions)

Our first question comes from the line of Jonathan Cuthra (phon) with JP Morgan. Please proceed with your question.

Jonathan Koutras:

Yes, hi. (Audio interference). I had two questions on my side. The first was if there was any one-off or anything worth mentioning looking at EBITDA margin on the Rest of the World segment that came in at strong levels? The second question was if the company considers to be behind its guidance and (inaudible) reference for the 2023 calendar year, and also the guidance for EV and structural components as a share of revenues. I'm sure you have this guidance of reaching 2 billion until 2025, it seems pretty clear you might reach that before 2025. Just to get a sense of how feasible this guidance is. Thank you.

Alberto Sada

Yes, Jonathan, thanks for your question. Let me answer the first one, then I would appreciate it if we could—maybe you can rephrase the second one because we couldn't follow you.

Related to the EBITDA that we experienced in Rest of the World, there were no one-timers. Most of it was related to better efficiencies. We had a good product mix and I think this is going to be consistent all along the year, where we will be seeing fairly better results than what we have had in the past in the region, particularly in Brazil.

Now, would you mind repeating the second question, please?, because we couldn't follow you precisely on what was being asked.

Jonathan Koutras:

No, sure. The question was if the company considers revising upwards its guidance for 2023, looking at EBITDA and revenues, growth has been, at least in the first quarter, came in at faster (phon) levels than guidance implies for the year. The sub question on that is, the guidance reaching \$2 billion in backlog for the EV segment components and considering the Company's really at 1.63. (Inaudible) revising upwards, this would be the 2.5 because it's pretty clear that, let's say, eight to nine quarters you might reach (inaudible) and that would be before 2025. So just to get a sense of that, something you guys are looking into.

Alberto Sada

Okay, Jonathan, let me answer the first part, and then I'll hand over to Armando for the second one.

The first part related to the guidance, I think what we saw in this quarter is consistent with what we have guided for in all the different elements. So we're not seeing any real pull-ahead of elements. I think, so far, what we saw in Rest of the World, as indicated, is a good performance and a good mix, which will be consistent all along the year, and the rest of the regions I think are aligned with what we had included in our yearly guidance.

Armando Tamez

Yes. Related, Jonathan, to the guidance, what we said was to achieve \$2 billion worth of new products in terms of electric mobility and structural components, as well as chassis. As we have informed everybody, we have achieved already \$1.63 billion, and we truly believe that our target of reaching revenues of \$2 billion that we set for 2025, we're confident that we will meet that number before 2025. I think that we have a very solid track record so far. I think we are performing well with our customers, and we have, as I already indicated, today, \$1.5 billion worth of new business opportunities. Certainly, we are very selective in terms of what are the products, the customers and the regions in which we would like to participate. Certainly, looking for partners that are attractive and looking for the highest profitability possible.

Jonathan Koutras:

Got it. Thank you, Armando and Alberto. Have a good day.

Alberto Sada

Thank you.

Armando Tamez

Thanks Jonathan.

Operator

Our next question comes from the line of Peter Bowley with Bank of America. Please proceed with your question.

Peter Bowley

Hello gentlemen. Thank you for the opportunity for a question. My question is on Nemak's fast growing exposure to EV battery housings. Can you share an update on where the industry is from a timing perspective in terms of shifting towards the use of composite resins in EV battery housings, and are there any future implications for Nemak EVSC margins if we see a greater adoption of composites in the industry versus other traditional materials? Any color around how Nemak may be preparing for that transition, if it's relevant? Thank you.

Armando Tamez

Thanks Peter. I think it's a great question. Certainly, our customers are looking for different set of materials and with the main objective of reducing weight and, of course, performance. Definitely, I think, carbon fiber and also other type of composites are being considered by customers in certain parts of the vehicles. We have seen a few customers looking at enclosures using composites.

One of the, let's say, advantages of this material is that it is lighter than, for instance, steel or aluminum, which I think is great for our customers to improve range. On the opposite side is composites are significantly more expensive than aluminum or steel and that's a significant drawback. We still believe that over the next five to ten years, aluminum will be the dominant material for battery tray enclosures as well as, for instance, structural components.

Peter Bowley

Thank you.

Armando Tamez

Thank you.

Operator

Our next question comes from the line of Pedro Nunes with Banco Finantia. Please proceed with your question.

Pedro Nunes

Hello. I wanted to ask in regards to working capital, which you mentioned was negative for the first quarter. I wanted to ask if you have an idea as to the impact that working capital could have in 2023 since in 2022 it was relatively neutral but 2021 was more negative. So I wanted to get some light on your expectations for this year. Thank you.

Alberto Sada

Hello Pedro. Yes, as we highlighted just previously, the working capital has two components of fluctuation in the first quarter. The first one is the normalization effect of what we saw as positive benefit in working capital in December. You may recall that on our last webcast, we highlighted that we received extraordinary collections as of the end of the year, which made our working capital balance significantly lower versus normal. So that basically got normalized in the first months, and then we also have the seasonal effects of the beginning of the year, which normally are an increase in working capital.

So we should be seeing working capital stay at these levels in the next quarters, and then gradually come back down at the end of the year due to seasonality effects. So, all in all, on a net basis, if we account for the last two years, the effect of working capital should be neutral, but if we compare this versus the end of 2022, it's going to be a net investment in working capital associated with these extraordinary receivables that we going to at the end of the year.

Pedro Nunes

Okay, thank you.

Alberto Sada

Thank you.

Adrian Althoff

Thank you. We will now move on to questions from the web. Our first question from Andres Cardona from Citi. First part of the question reads: "How much did you spend on launching expenses during the first quarter of 2023? Can you remind us the budget for the year for launching expenses?" The next part of the question is an update on talks with clients about labor cost inflation.

Alberto Sada

Okay. Let me answer the first part of the question. Yes, certainly, we have a lot of activity with launching products all over, so when we normally have these type of activities there are higher expenses associated with those launches. Normally, those are part of our budgets and they are incorporated in our business plans.

Yes, during the first quarter we also had launching expenses. Those were on the single-digit basis, higher single-digits. So that was part of the results reported in the first quarter.

Adrian Althoff

Our next question comes from...

Alberto Sada

There's a second part.

Adrian Althoff

Yes.

Alberto Sada

Yes. Now related to the second part of the question about the update on the labor cost inflation discussions with customers, those are part of the discussions that we have engaged already since the end of last year geared towards the effects that we're experiencing this year. Those discussions are ongoing. So I think we're moving in the right direction but there's still pretty much work to show what is the final outcome of those discussions. We trust that those discussions will end up in a favorable way with our customers.

Adrian Althoff

Next question comes from Alfonso Salazar from Scotiabank. It reads: "Given the ongoing price reductions of vehicles, which are pressing the margins of OEMs, How likely do you think it is that the next wave of new contract negotiations may be under less favorable conditions for Nemak?"

Armando Tamez

Yes. Thank you, Alfonso for your question. Let me put it in context. I think we need to realize—and we're following this very, very closely. The average transaction cost or price of new vehicles in the U.S. today has been in the range of about \$49,000. That's the average. We have seen over the last few months that prices are going down at approximately between \$500 to \$1,000. That is a fact. However, we need to remember that the prices have been increased over the last two years after the pandemic and the semiconductor shortage by about \$10,000. So, if we take a look at the margins that our customers are having, on average, it's about \$9,000 more than what they have just a couple of years ago.

I think with the margins that our customers are getting are historically high, and certainly, as we have indicated, we are very sensitive and we are targeting what we believe is the most profitable parts. So, in that regard, we're very selective and we think that we can continue getting reasonable margins on our new products and our new contracts.

Adrian Althoff

The next question also comes from Alfonso Salazar. How do you anticipate free cash flow to be positive again considering the Capex needs over the coming years?

Alberto Sada

Yes. Well, certainly, as we have been sharing, the Capex figure for this year is higher than what we had in the past, and this is basically associated with the intense transformation that we have started with our business. The Capex figures will gradually be coming down in the next years, so we expect that with that driver, plus a better result associated with higher volumes and better mix, will start shifting our free cash flow to be positive in the near future.

So we are confident about moving in that direction. We're extremely well concentrated in minimizing the amount of Capex that we need, but certainly given these products that we have in front of us, the amount is higher than what we had in the past. But again, the drivers going forward will be EBITDA growth and then gradual Capex reduction which is going to drive positive free cash flow soon.

Adrian Althoff

The next question is from Vidal Aragón from SCA. It reads: "What would be the core impact related with the business with the arrival of Tesla in Nuevo Leon, Mexico?"

Armando Tamez

Yes. I think that that's a good question. Certainly, I think we need to remember that we're in an area in the State of Nuevo Leon and also very close to the State of Coahuila, in which we have already participants, OEMs, including, for instance, in the case of Nuevo Leon, Kia, which have very large manufacturing facility, as well as we have not too far from where we are located, GM, with some facilities close by our plants, as well as Stellantis, formerly Chrysler, with also two large plants, engine plant, plus assembly plant.

So, we truly believe that with the coming of Tesla, certainly, it will be, let's say, some competition for talent as well as other services but I think will open the door also for opportunities to do business with a company that has a nice reputation.

So, overall, we see this as positive for the state and positive for the country.

Adrian Althoff

The next question comes from Agustin Bonasora from PineBridge. The question reads: "The tax paid seems higher than previous years. Can you clarify this figure and if we should expect this level of tax going forward?"

Alberto Sada

Yes. Agustin, certainly the tax figures that we're experiencing this year are higher than last year. The reason for that is because last year we had fairly low provision tax rates associated with the results we had in the previously year. Gradually as the results continue to improve, we should be seeing a normalization of the tax rate going forward.

So I think what we're seeing right now is consistent with what we're going to be seeing in the rest of the year.

Adrian Althoff

Our next question comes from Pascal Nipoli (phon) from GIB AM (phon). It reads: "What do you expect in terms of cost inflation, margin developments going forward in 2023? Also if you could please explain which items drove the FX loss?"

Alberto Sada

Well related to our margins going forward, I think as we highlighted, we have been very actively engaged with our customers to pass through all the major inflation impacts that we're seeing, not only the energy that we saw last year, but also labor and a few other elements. So we should be seeing those negotiations, hopefully, concluding favorably in the next quarter. So that should help us normalize our EBITDA margins

and take them to at least the levels that we have guided for, which are similar to what we had last year, which are in the neighborhood of \$13.6 per equivalent unit.

So, hopefully, if those discussions continue developing well, we should be seeing a better performance.

Adrian Althoff

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.

Operator

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