

GIS 2Q21 EARNINGS CONFERENCE CALL
July 23, 2021 @ 9am CT

Melanie Carpenter: Good day everyone, welcome to GIS' second quarter 2021 earnings conference call. Joining us today is GIS' Chief Operating Officer, Mr. Jorge Rada, GIS' Chief Financial Officer, Mr. Saúl Castañeda, and GIS' Investor Relations Manager, Mr. David Sandoval.

Please be advised this call is for investors and analysts only. During this call, they are going to be discussing GIS' performance as per the earnings release that we issued yesterday. If you did not receive the report, it is now available on the website gis.com.mx in the Investor Relations section. We encourage you to follow along with the on-screen presentation.

All lines have been placed on mute to prevent any background noise. There is going to be a question-and-answer session after the speakers' opening remarks, and I will give you instructions at that time on how to ask a question.

Let me just remind you that forward-looking statements may be made during this conference call. These are based on information that is currently available and that information may be subject to change due to a variety of factors. For more detail and a complete disclaimer, we ask that you please refer to the earnings release. Also, all figures discussed today are going to be in US dollars, unless otherwise noted.

It is now my pleasure to introduce the GIS team. Mr. Jorge Rada will begin the call, so please go-ahead Jorge.

Jorge Rada: Thank you, Melanie, and thank you all for joining us today.

On behalf of GIS, we hope that you and your families are in good health.

We would like to start today's call by sharing very good news. The higher regional content required by the US MCA has increased the demand for iron components, this trend in addition to a better

outlook for the automotive industry has favored Draxton's order book which shows an optimistic volume growth in the next years.

Based on this, we made an important announcement in yesterdays in earnings release, an investment project for capacity expansion in Draxton Mexico. This investment in San Luis Potosi plant will amount \$30 million dollars and with this project, we will add 30,000 tons of capacity for castings per year. This will lead Draxton's annual capacity, globally, up to 620,000 pounds. The new ductile iron casting line will focus mainly on the production of brackets and calibers used in automotive brake systems fully compatible with hybrid and electric vehicles. The start of production is expected for the last quarter of 2022 aligned to the industry gradual recovery path, strengthening our leadership in the manufacturing of components for brake systems.

Regarding the second quarter results and its highlights, I would like to share with you that despite the short-term limitations in vehicle production due to the shortage of semiconductors, vehicle demand remains strong and based on Draxton's competitiveness we have been awarded new programs for 80,000 tons globally during the year, mainly for brake systems that, as I previously mentioned, are fully compatible with hybrid and electric vehicles.

Without major investments required, Vitromex took actions to boost capacity by approximately 10% by upgrading several manufacturing processes, however, these measures impacted production volume in sales during the quarter, we carried out these improvements with a long-term mindset to produce higher volumes and serve expected demand.

Revenues at Cinsa continue to be dynamic, during the quarter sales grew 9% in the domestic market and 11% in exports quarter over quarter. We increased efficiency at Cinsa through important right sizing efforts which upset the majority of the increase in the price of the cold rolled steel.

I will now pass the presentation over to Saúl Castañeda our CFO.

Saúl Castañeda:

Thank you, Jorge, and good morning, everyone.

I hope you and your families are staying healthy and safe.

The dynamism in all regions where we operate continues, conforming the trend towards \$1 billion in annual sales.

During the second quarter, despite the semi-conductor's shortage and the impact of actions taken to increase Vitromex's capacity, revenues at GIS were \$250 million, which maintains our sustained growth in the industries where we participate.

Regardless of the significant challenges in the automotive industry and increases in raw material prices, such as strap iron and cold rolled steel, GIS post a solid performance, with an EBITDA o \$35 million during the second quarter.

I must emphasize that the last twelve months EBTIDA figure reached \$153 million and now standing level.

At the end of June, we executed the re-financing of Evercast' loan, improving maturity profile, with a reduction in the interest rate.

Moreover, on July 15 we made an early payment on our syndicated loan for \$14 million.

On the left-hand side, you can see the debt maturity profile before both events, the re-financing, and the early payment. On the right-hand side, you can see an improvement on maturity profile for the upcoming years, considering the early payment on a performance basis.

As you can see, virtually GIS will not have debt payments for 2021 and 2022 strengthening our financial position to support San Luis Potosi expansion project and other working capital investment requirements.

GIS maintains its solid financial position and continues to reduce its net leverage ratio, which, by the end of the quarter was 1.2 times.

This level was achieved based on the consistent financial results in each of our businesses, as well as the financial strategy mentioned before.

As a result, GIS gains financial flexibility to explore strategic opportunities for growth and value creation for our shareholders.

I will now hand the presentation back over to Jorge Rada.

Jorge Rada:

Thank you Saúl.

In the second quarter of this year, improvement across regions where GIS operates was highly influenced by better vaccination rollout, stimulus packages and the faster reopening schedule.

The US and China are recovering at a faster pace and by the end of these year we will have exceeded the pre-pandemic economic activity by 5% and 10% respectively.

On the other hand, the pace of recovery in Europe and Mexico is slower and the economies are expected to reach pre-pandemic levels by the end of 2021.

The economic rebound continued to pressure supply chains and increase commodity prices, such as cold rolled steel and scrap iron. Regarding steel prices we have been seen an increase of more than two times during 2021.

Scrap iron prices have risen more than 50% in the first half of the year, which will be indexed in our prices during the next months.

At GIS, we have been able to partially offset these impacts through operating efficiencies, productivity, and the optimization of our purchasing processes, we expect supply prices to normalize in the second half of the year.

Now I will turn to the automotive industry. In North America, vehicle demand is approaching pre-pandemic levels. The global shortage of semiconductors has limited the production of vehicles, which has caused pent up demand as dealers face low inventory levels.

In order to meet demand and replenish inventory levels, OEMs will focus on increasing their production in the second half of the year.

During the second quarter of 2021, sales in Europe increased by 69% year over year so markets have created incentive programs, mainly for electric vehicles to continue with the industry recovery.

In China, although vehicle sales showed a 2% reduction against the second quarter of 2020, accumulated sales grew at 24% year over year. Strong demand for vehicles is expected for the second half of the year.

Moving on to Draxton's performance. During the second quarter, our global casting volume increased 172% year-over-year and the industry was heavily affected during the second quarter of 2020 due to the general shutdowns.

For Europe and Asia, the growth was 139% as demand for commercial vehicles increased in Europe, while China's market is getting stronger.

As a result of our strategy to grow in machining, during the second quarter we recorded the highest sales at our facility in Lleida in Spain.

Our global sales have recovered to pre-pandemic levels, and we recorded sales of \$177 million, which is a 211% increase year over year, mainly due to volume increases and indexation of scrap iron prices.

EBITDA closed at \$30 million, impacted by a limited volume related to semi-conductors' shortage and the \$4.4 million effect of scrap iron price increase.

Additionally, we saw higher electricity prices mainly Europe, which also raise our margins, the implementation of efficiency and productivity improvement programs partially mitigated these challenges.

During the second quarter of 2021, Draxton won new contracts for 50,000 tons per year, which, in addition to the contracts awarded during the first quarter amounts to 80,000 tons per year, to be launched in the coming two years.

One of these of these contracts, which I would like to particularly mention or highlight for you is a control arm, that will be assembled in a new electric vehicle for a leading electric vehicles manufacturer.

Among more than 4,200 automotive suppliers, Draxton Irapuato received the 2020 supplier quality excellence award from our

customer General Motors in recognition of its excellent performance in quality and service during 2020.

Now, moving on to Vitromex. Vitromex's revenues rose 46%, year over year and reached similar levels to the first quarter of 2021.

Vitromex has thus confirmed the solid trend towards profitability recovery with another double-digit EBITDA margin for acquire.

Vitromex's ability to capture benefits from the extraordinary demand and sustained cost reduction efforts lead the business to obtain an EBITDA of 417 million pesos on a last 12-month basis.

The positive trend in revenue was supported by a dynamic domestic demand rising orders from key customers in the US and a normalization of operations in South America.

Exports to the US and South America continue growing quarter by quarter, as the commercial strategies aimed to these regions take place. We will continue seeking for opportunities to increase our participation in the US through different programs and customer relations.

During the second quarter or production was limited due to several actions taken in order to improve our capacity. We think it is important to focus on the long-term strength of our business and to ensure future flexibility.

The increase of our capacity by approximately 10% will enable us to satisfy the demand from both the domestic and the export market.

EBITDA performance confirms the success of the turnaround process launched by Vitromex in 2019 reaching 128 million pesos, or 11% margin for the second quarter of 2021.

We continue to roll out our commercial strategy in the US, our exports have increased continuously over the last several quarters up to 78% compared versus the fourth quarter of 2020, or 35% versus the last quarter. We believe this trend will help us meet the objectives that we have established for the business for the second half of the year.

Now regarding Cinsa, the business is showing sustained sales growth with 524 million pesos in the second quarter two times the second quarter of 2020 level and a 63% higher than pre-pandemic levels.

The trend for the cookware business remains positive, we were able to partially compensate higher cold rolled steel prices and we reached an EBITDA of 45 million pesos or 9% margin.

This concludes my remarks for today. Thank you for your attention and Melanie, please begin the Q&A session...

Melanie Carpenter: Excellent. Thank you, Jorge.

Ladies and gentlemen, at this time we're going to open the floor for questions so first we're going to take questions from the conference call participants and then we will follow with questions from the chat.

If you want to ask a question via Webinar, just press the hand button, once your line is opened, a popup window will appear to confirm that your audio is active, we ask that you on that and then please, say your name and Affiliation. In case you are connected via phone, press the star key, followed by nine. Once your phone line is open, press the star key, followed by six before start speaking, again, please say your name and Affiliation.

If you are on the Webcast, there is a question mark button on your webcast player. Please, press that and a popup window will appear, enter your question and press "Send", so give us just one moment we're going to see where we stand with questions at this time.

Okay wonderful, we have a question from Alejandro if you'd like to activate your audio Please go ahead, Alejandro.

Alejandro Azar: Hi Saúl, Jorge. This is Alejandro Azar from GBM.

I have three questions, the first one is on your new or improved flexibility to analyze growth opportunities, I mean, I just want to get a sense of where are you analyzing this, is it across your three business units? Or is it only Draxton? That would be the first one.

The second one, also in the auto parts business, with your current contracts on hand and these new expansions that you mentioned, would you say that you feel comfortable with the capacity of Draxton, at least on the 2024?

And the third one is on Vitromex. You said growing exports to the US and Central America in the upcoming quarters, or maybe 2022. If we were to take 2020 exports levels, what growth would you be expecting for, I don't know, 2021 or maybe 2022? Those would be my three questions, thank you.

Jorge Rada:

Well, in terms of strategy or possibilities to expand our business, we are very, very confident that with the financial position that we have today and the solid numbers on our balance sheet, we are able to continue, or we are in the position to continue doing some progress. Remember that we made some important acquisitions in 2015 and 2016 and we expanded Draxton globally.

In the automotive industry, we think that there will be some opportunities to continue growing organically and inorganically, organically for example, yesterday we made an announcement of an investment in Mexico, and we think that not only organic growth is possible, but we can also imagine that in the future, we can participate in the consolidation of the industry.

This is a very dynamic industry, and we think that we have some opportunities, not only in Mexico, but also in other continents.

Regarding Vitromex, we think that in addition to the capacity that we released, let's say by making some actions in Mexico, it might be possible that we will have to continue increasing capacity because we see very strong demand and we are seeing very positive perspectives for our volumes in the US, Central and Latin America, that is why we are very optimistic also about the future of Vitromex.

Regarding the capacity for Draxton, the new investment that we will put in San Luis Potosi will start production by the end of next year, so we are confident that this capacity will be utilized almost immediately, or actually we will have to rush, because we have programs awarded and contracts for the long-term and we are very confident that this investment will be very, very successful.

Depending on the dynamic of the industry this might not be enough, and maybe that was your question, if the capacity will be sufficient to attend the demands of the industry, and at the moment this is why we have in our medium-term vision but we will be alert and we will be always watching what are the needs of our customers in the industry, and we will be in a position to capture these opportunities.

Regarding Vitromex in the US and Central America. I think I mentioned a little bit in the first part of my answer that we see very optimistic perspectives and we feel that the volumes will grow and our quality, our service level and the productivity that we have achieved recently in our strategy for, let's say attacking the US market, in our opinion we feel very comfortable with what we are doing and we have very important key customers that we are developing, and we feel very optimistic that in the next years we will have very good volumes back in the US as we used to have in the past.

We are very optimistic about not exactly the short term, because the short term has a real problem, but once the situation normalizes, we are cautiously optimistic that we will get new businesses and our plans will be running at full capacity in all the regions. In Mexico, we are considering already an additional investment to the one that we announced it in the last quarter.

Alejandro Azar: Excellent. Thank you very much Jorge, and greetings to both of you.

Jorge Rada: Yes, yes. Thank you, Alex.

Saúl Castañeda: Thank you. Greetings

Melanie Carpenter: Alright, we are now going to take a question from the webcast. We have Carlos Alcaraz, who is asking regarding Vitromex, if you have any forecast for the year and EBITDA that you can share with him.

Jorge Rada: Saúl, you would like to take that one.

Saúl Castañeda: Sure, I can take this one, Jorge.

Hi Carlos, thank you for your question.

We do not provide guidance as an official metric or reference for the market, but we believe the analysis for the last four month's figure that we mentioned, is a pretty good reference to measure the capabilities of Vitromex's team. As Jorge mentioned, the volumes that we achieved and the cost reduction gave us a great performance on Vitromex, so we don't have, as I mentioned, a guidance policy, but I can say that the last four months figure is a pretty good reference.

But let me also add that we are not at the end, in our goal our target for Vitromex is a high double-digit EBITDA margin, it is important to emphasize that, Carlos.

Jorge Rada: Yeah, maybe I can add that there are a lot of opportunities in the operations. We have a very committed team, very capable, and they are making a lot of improvements in the processes, improving costs, productivity and the volumes of course will grow, so our expectation is that you will be seeing better numbers as we go along with the quarters over the year.

Melanie Carpenter: Excellent gentlemen. Ladies and gentlemen of the audience, please, if you have any questions, you can hit the raise hand button, you can also on the webcast player hit the question mark button. The gentlemen are available to answer your questions, so please let us know if you have a question at this time.

I believe Carlos has raised his hand we're going to enable his audio.

Carlos, go ahead. Please.

Carlos Alcaraz: Hi Jorge and Saúl, good morning. I have some trouble with my microphone, can you hear me?

Jorge Rada: Yes, very well Carlos. No problem.

Carlos Alcaraz: Thank you.

I just have one more question, it's about Cinsa. Given the growth in aluminum prices will we see changes in the Cinsa strategy going forward?

Jorge Rada: Can you elaborate a little bit more in your question?

Even though they have some inventories, which is very difficult to estimate for us, they have to build up inventories. They haven't been able to sell enough cars because they haven't cars at the dealer. Our expectations and what the best analysts in the industry are forecasting is that production volumes will recover next year.

Of course, the highest volume will come, maybe in the 2023 but in 2022 they are forecasting higher production volumes. We are at the moment focusing a lot on production of cars more than in sales because of the reason you are, you are mentioning.

In the supply chain, we are linked to production. We must be very close to our customers, so we can be prepared to catch up in the moment that they start ramping up because everybody is saying that it may be a very, very fast recovery.

Alejandro Azar: Regarding that very fast recovery Jorge, and with the current price of commodities, of steel, do you think that the pent-up demand could tighten more demand for your raw materials, when that big production comes across all the industry?

Jorge Rada: The thing is that there is a bottleneck at the moment because prices are so high that everybody's trying to adjust to this situation, but all the industry is negotiating with the customers across the supply chain to try to agree on contracts or temporary relief on prices or everybody can continue producing.

Some of the producers of, for example, raw materials say that the energy cost is so high that it doesn't make sense to produce those costs but if the prices are adjusted, then they will continue producing. Their supply chains will continue to be tight, but OEMs are able to transfer this higher cost to the market and if they are willing to pass this to the supply chain, we believe that the suppliers will continue producing. At this moment, there is a turbulence in the market, because some companies are being harmed very strongly because of these high prices.

Alejandro Azar: Great Jorge. Thank you. I will move on to other questions.

On Vitromex, do you still see margin improvements ahead despite increasing natural gas prices and, if you could take us through how you would achieve this.

Carlos Alcaraz: Given the growth in the aluminum prices, will we see changes in Cinsa's strategy? Going forward what is your forecast about this aluminum prices change?

Jorge Rada: Okay, well, we have products in aluminum and steel. The commodities have increased their prices significantly in the last month and we don't think that this is sustainable, so we are working very strongly on productivity efficiencies.

This has enabled us to offset most of these cost increases, so we don't see that this is going to be a permanent effect on us and it's affecting the whole industry, all the competitors and the companies that are producing the same products, are facing the same situation so we have been able to transfer back to the market, because this is normal, when the cost of the inflation is there, companies absorb or offset a portion, and some others have to be passed to the market. We must be very careful just to make sure we don't exceed prices and affect our market share or preference from the customers, but we don't see a dramatic change in our strategy based in this, especially because we don't see this to be a permanent situation, this was created by the re-opening of the economies and some commodities have an extremely high price that is not sustainable in the future.

Carlos Alcaraz: Okay, that's awesome. Thank you, Jorge and Saúl.

Jorge Rada: Thank you, Carlos.

Saúl Castañeda: Thank you.

Melanie Carpenter: Okay, ladies and gentlemen, just as a reminder, if you have any questions, we're just going to pause a moment to see if we have any other questions, while we have our gentleman here.

Please don't hesitate to raise your hand or to hit the question mark button on the webcast player and we'll take your question will pause just another moment.

Alright, looks like we have no more questions at this time, so I will turn it back to Saúl for some closing remarks.

Saúl Castañeda: Thank you, Melanie, and thank you once again for your interest in GIS, please don't hesitate to contact us if you have further questions and we hope you stay healthy and safe Have a nice day.

Jorge Rada: Thank you very much.

Melanie Carpenter: That concludes the event, and you may now disconnect. Thank you everyone.

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