GIS 3Q21 EARNINGS CONFERENCE CALL
October 22, 2021 @ 9am CT

Melanie Carpenter: Good morning everyone, welcome. We are going to be initiating the zoom webinar shortly, please just stand by. Thank you.

Ladies and gentlemen, we are going to begin momentarily, please stand by.

Ladies and gentlemen, we are going to begin.

Good day everyone, and welcome to GIS' third 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. Arturo Morales.

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 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 is 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 stated.

It is now my pleasure to introduce the GIS team. I'm going to turn over to Saúl Castañeda to begin the call. Please Saúl.

Jorge Rada: Good morning everyone, this is Jorge Rada.

Thank you Melanie for introducing the presentation 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 this call by talking about the situation of the auto industry. During this third quarter and throughout 2021, the industry has been affected by three external and temporary challenges.

First is the global shortage of semiconductors.The low supply of these components allocated to the auto industry has limited the production capacity of the OEM's, and of course, the whole industry. We believe the impact of the semiconductors shortage has reached its peak and production of vehicles will begin to grow starting the fourth quarter of this year, and will largely recover during the first semester of 2022, as the supply of semiconductors normalizes.

Second, raw material's price increase. During 2021 the prices of scrap iron and ferroalloys have risen to unprecedented levels, with more than 100% increases. As you know, the indexation formula takes about 3 months to reflect these increases into our prices, so this metal lag misaligns our price-cost structure, resulting in temporary lower margins. Scrap iron prices are starting to stabilize, and this will significantly reduce the impacts on our margins going forward.

And third, the high energy costs in Europe. Prices of electricity in this region have reached to new highs in the last weeks. A combination of higher carbon-based energy generation and lower natural gas inventories, as well as the deferral of the Nord Stream 2 pipeline have caused prices to peak. However, forward energy prices show a stabilization by the second quarter of 2022, which will significantly reduce the impact of the energy prices.

As I mentioned before, these effects are temporary and external. Draxton will continue to implement rightsizing measures to mitigate the impact of these effects. The new programs we have been assigned during the year for 115,000 annual tons, confirm our solid fundamentals and the competitiveness of our business.

We will be prepared for the pent-up demand as the industry normalizes. The investment announced for our San Luis Potosi plant is taking its course and will be ready by the end of next year. Based on our commercial performance and the industry growth expectations in North America, we are considering an additional expansion in Mexico.

I will now hand the presentation over to Saul Castañeda. Saul…

Saúl Castañeda: Thank you Jorge and good morning everyone.

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

Our top-line growth trend continues. With this quarter's $248 million revenues, annual sales growing towards a new high.

During this quarter, revenue grew 21% year-over-year, driven by: Higher volume in Draxton North America, mainly related to new product launches and the consolidation of Evercast´s third line, which was launched last year.

Draxton´s indexation formula, that reflects the increase of raw materials into prices, partially offsets the impact of lower volumes in Europe, and finally, strong dynamism in local consumption as well as higher exports in Vitromex and Cinsa.

A challenging short term scenario in the auto industry, caused by semiconductors shortage, historical iron scrap and other raw material prices, as well as higher energy costs, has temporarily affected our EBITDA, which during the third quarter stood at $23 million dollar or 9% margin. Stabilization of these external factors in the next quarters, should bring an important recovery in our margins.

Last twelve month EBITDA figure amounts to $138 million.

Our debt strategic actions deployed last quarter and consistent financial performance, provides a solid financial position with a Net leverage ratio of 1.4 times, emphasizing no debt service payments required during 2021 and 2022.

A strong financial position allows GIS to continue supporting capacity expansions within its different businesses and also,

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.

Pressure in supply chains continue to push for higher commodity inflation. Steel prices have risen almost 3 times during the year. Although Scrap Iron prices are starting to stabilize, during the year they have increased more than 100%. These higher costs are indexed in our selling prices with an average lag of three months. In addition, Energy cost in Europe has increased almost 3 times throughout the year to unprecedented levels. Analysts believe the normalization will begin in the second quarter of next year.

We have started to see a change of trend in the last weeks, and we expect input prices to normalize gradually during 2022.

We have rebooted rightsizing plans, similar to those of 2020, to provide our operations with flexibilities and partially offset these impacts.

I will now shift to the automotive industry. In North America, vehicle demand continues strong. In accumulated figures, auto sales grew 14%, in spite of this quarter's 9% decrease, which is explained by the global shortage of semiconductors that is still limiting the production of vehicles. Third Quarter Vehicle Production was down 23% year-over-year, which has pushed vehicle inventories to less than 25 days at the dealers.

Sales in Europe increased by 11%, year over year in the first nine months. The vehicle production in this quarter decreased 21.3%, because of the same supply chain limitations. Analysts expect a recovery in production levels starting in 4Q21 and be extended throughout 2022.

In China, vehicle sales showed a 6% increase year over year by September. However, this quarter vehicle production and sales decreased 17% and 16% year-over-year. Government incentive and subsidy programs for electric vehicles have been extended to 2022, seeking to benefit the local market.

Moving on to Draxton's performance. During the third quarter, our global casting volume increased 2% year-over-year, in despite of the vehicle production limitations. In North America the volumes of new programs and the launching of Evercast's third line, have mitigated these external challenges.
In Europe and Asia, our volumes decreased 6%. Volumes for commercial vehicle programs are growing, bringing a better mix of products for Europe, while China remains in a strong position based on its solid order book.

In the quarter, Draxton recorded sales of 169 million dollars, which is a 19% increase year-over-year, mainly due to indexation of scrap prices in the prices of our products.

Accumulated EBITDA closed at $83 million dollars, 42% higher than 2020 figures. In the quarter Draxton's EBITDA was impacted by lower volumes related to the global semiconductor shortage, higher prices of scrap iron and energy. These temporary effects are expected to normalize in the next quarters, as some of these prices have already started to show a change in tendency.
During the third quarter of 2021, Draxton won new contracts for 35 thousand tons per year, which in addition to the contracts awarded during the first half of the year, amounts to 115,000 tons per year, to be launched in the coming two years. I believe important to highlight that most of these new contracts include components for brake systems, which are 100% compatible with electric vehicle platforms.

Based on our successful business acquisition performance and the industry's volume expectations, in addition to the investment in a new foundry line announced last quarter and which will be ready by the end of next year, we are considering an additional capacity expansion in Draxton North America.

Moving on to Vitromex. Vitromex´s revenues grew by 8%, year over year. The growth trend continues, reaching record sales levels in the domestic market and with a greater export contribution.

This quarter's EBITDA margin stands at 12%, confirming the solid results of its sustainable profitability strategy. The efficiencies in operations that are still being implemented, as well as the investments to increase installed capacity, will continue to boost profitability and margin expansion.

EBITDA in the last twelve-month basis amounts to $442 million pesos.

Higher volumes and a better product mix helped sustain our positive trend in revenues, supported also by the dynamism of demand in the market.

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.

In September, we approved an investment of $11 million dollars to increase Vitromex's installed capacity by 2 million square meters of annual production. This investment, added to the efficiencies implemented last quarter, will increase our total production capacity by 15% to support our growth strategy.

EBITDA performance continues to confirm the success of the turnaround process, reaching $123 million pesos, or 12% margin, for the third quarter 2021.

Regarding Cinsa. Top-line growth trend is confirmed in this quarter, posting a 31% increase year- over-year. Higher exports to the USA and Canada support this growth.

The business achieved better volumes, product mix and operational efficiencies that partially mitigated the impacts in the quarter related to the increased cost of raw materials, like cold rolled steel, which has tripled in the year.

This concludes my remarks for today. Thank you for your attention.

Melanie, please begin the Q&A session...

Melanie Carpenter: 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".

We are going to take our first question comes from Carlos Alcaraz, go ahead Carlos.

Carlos Alcaraz: Thank you. Good morning Jorge, Saúl. Thank you very much for the call, this is Carlos from Apalache Análisis.

I have a couple of questions, the first one is would the increase in energy prices, can we expect an investment plan for electric energy in the future? And the second one is, given the current situation, can we expect new contracts for Draxton in the last quarter of the year? Thank you.

Jorge Rada: Yes, Carlos. Thank you for your questions.

Well, with energy prices, we are not, at this moment, considering investing in energy or cells, but what we are trying to do is to try to follow the futures or the forward market prices and to try to protect the futures. We have done this in the past.

We haven't found the right moment this time to fix the prices and to make contracts for the future, but the good news is that we see a very good trend of recovery of the prices, starting in the second quarter of next year.

We are already considering making contracts in which we will not have an obligation to buy energy, but we will have fixed prices, so we can do that in layers, we will not make only one contract. We will consider different contracts so we can protect the prices for next year. This is for the first question.

In the second question, if we are considering or expecting additional contracts for the next quarters. I'm very happy to tell you that yes, we are moving very strongly commercially with different customers. We are taking advantage of several geopolitical and geographical situations in which companies are trying to nearshore and try to buy more locally. For example, in Europe, what we are doing at this moment is considering companies that are relocating production from other regions to Europe and we see very good perspective in terms of volume acquisition in the next quarters. Everything that we gain, for example, if we win a contract in the fourth quarter this year, it will be launched in the next 18 to 24 months.

Fundamentally, the industry is good. Unfortunately there is a scarcity of semiconductors and once the situation comes back to normal, we think that we will be totally prepared to deliver all the volume that is needed for the pent up demand and with the new programs, we see our future volumes continue to grow.

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 of the regions. In Mexico, we are actually considering already an additional investment to the one that we announced it in the last quarter.

Saúl Castañeda: If I may, Jorge. I would like to add Carlos, that as you know, most of these volumes or awarded are fully compatible with hybrid electric vehicles so it is another important aspect for us.

Carlos Alcaraz: Okay that is clear, thank you very much. Congratulations for the results.

Jorge Rada: Thank you.

Melanie Carpenter: Thank you Carlos.

Ladies and gentlemen, if you would like to ask a question, please press the button on your webinar portal.

Now we have a question from Alejandro Azar. Please go ahead Alejandro. You can unmute yourself.

Alejandro Azar: Thank you for taking my questions. Do you hear me well?

Jorge Rada: We hear you with a very low volume. I don't know if you are far away from the microphone.

We can hear you. Maybe in the interest of time, you can ask the question.

Alejandro Azar: I have three questions, the first one is on Draxton, I am a bit worried about OEMs inventories that are only are awaiting to install chips and already have your products, how we think about this [inaudible] a problem to a Tier One, Tier Two players ramping up production next year. That is the first one, if you want to answer that and then I will follow with the second one.

Jorge Rada: If I understand your question, you are worried that the OEMs high inventory of cars or vehicles that are not completed because they are missing some component because of the chips.

Alejandro Azar: And that those cars already have your products but are only awaiting to have their chips.

Jorge Rada: Your concern is that maybe the recovery will not be so fast.

Alejandro Azar: Yes

Jorge Rada: Remember that the inventories, especially in the US are extremely low at the dealers.

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 have to 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.

The third one would be, when you say strategic opportunities, could you share with us a bit more on where are you looking at? Perhaps Draxton, Vitromex, organic, inorganic growth. Those would be my last questions, thank you.

Jorge Rada The first question Alejandro. We definitely are in a very good track and improving our costs because of productivity improvements, efficiencies and everything, in the plants in Mexico, the four plans we have.

However, we are still in the way, we are not where we want to be so definitely we continue working on cost reductions and efficiencies and with this additional programs that we are implementing, we believe that we have still some margin for

improvement and to compensate at least partially the increases of energy.

We don't believe that energy will continue growing forever. Actually, there are some news in the US that because of the autumn, the weather is going to be a little bit milder or warmer than expected. Probably inventories are going to be higher and the prices are not going to be as high as expected, talking about natural gas. Based on our productivity improvement programs, we have very high goals for cost reduction, so we definitely expect that the margins will continue to grow in Vitromex.

Regarding the strategic movements, for example, we are announcing that we are increasing capacity in Vitromex and we are going to install a new kiln in San Jose in Guanajuato. We will continue adding more capacity as demand continues to be high. We want to continue growing, and we are actually targeting the US market and export markets in Latin America.

Adding capacity in Mexico is going to help us to continue growing together with the market. We continue to see a very strong demand, especially for remodeling in Mexico and with our new US strategy, we will definitely continue growing with capacity.

The first initial move is in Guanajuato [inaudible] we believe, maybe in the future, we will [inaudible] additional investments to continue with production.

In the case of Draxton, we see as we have mentioned in the past, a trend in the industry in which we could participate in the consolidation. At the moment, we don't have any news or anything that we can share but definitely, we are very keen to see how the development of the industry continues and definitely we consider Draxton to be in a very good position to participate in the consolidation of the industry, that is the way we are managing Draxton for the growth.

We have very good news in terms of organic growth, for example, we are adding capacity in San Luis Potosi. Based on the programs that we have won recently, we have already in our plans to consider an additional expansion, even in Mexico. In China, we have a very good order book and we definitely want to continue growing in China, so we are analyzing different paths of how we can grow and we see a very good perspective for the future.

Alejandro Azar: Right, excellent. Thank you, Jorge, Saúl.

Melanie Carpenter: Thank you Alejandro. Our next question comes from Laisha Carrillo, you are going to be ask to unmute your microphone, go ahead Laisha.

Laisha Carrillo: Hi, Jorge and Saúl. This is Laisha from GBM, thanks for taking my question.

Do you think you could share the magnitude of the metal lag impact during the quarter? That would be my first question, what is the figure for the metal lag during the quarter.

Saúl Castañeda: Thanks Laisha. If you like, we can answer the first one. As you remember our first half impact of metal lag was around $10 million dollar, five each. In the third quarter, it was a pretty similar amount for the quarter, it was around 5 million again just for the metal lag.

Laisha Carrillo: If we add this impact to the past quarters', we will be amounting up to roughly 15 million US, right?

Saúl Castañeda: 15 millions for nine months

Laisha Carrillo: Three months that's right yeah.
Then, considering scrap prices remain flat, as you said, or if they stabilize next year, do you think we should add this figure to next year's EBITDA?

Saúl Castañeda: Yes, it's an important question, and please Jorge, compliment me if you would like to. At least for the end of the year Laisha, for the fourth quarter, we are expecting the impact to go probably to zero so yes, it's a good conclusion that that you made. In fact, just for a normalized scenario for metal and scrap iron prices, we are not considering or we're not talking about decreasing prices, we are just imagining a stabilization in prices, but, as you mentioned, it will be fair to analyze in that way, to add that amount for projection of next year's EBITDA.

Jorge Rada: For example, we are normally selling at the prices of the previous quarter, so we have an average of three months lag across all the products. What we are seeing at this moment, is that the scrap prices are not growing anymore, this is what we see at the

moment. Actually, we see a slight decrease in scrap prices, so we don't expect the metal lag to be there in the results of the fourth quarter or maybe, it's going to be very, very low, and then, if the prices continue to be stable it doesn't matter the prices continue to be high, as long as the prices don't move, then the metal lag will be close to zero. If the scrap prices start to go down then, temporarily we will have the opposite effect in which we will have temporarily maybe better margins, because we will be again selling at prices of the previous quarter but buying scrap at the prices of the current month, so this is the effect. Unfortunately, the prices of the scrap grew so fast, this year, that the impact of the metal lag was very, very strong.

Laisha Carrillo: Okay, thank you very much for taking my question.

Jorge Rada: Thank you for the question Laisha.

Melanie Carpenter: Thank you, Laisha.

Just a reminder, ladies and gentlemen, if you want to ask a question, please press the question button on your webinar, we are just going to pause a moment.

Also, if you want to ask a question, via the chat function, please do so as well at this time.

We're not seeing anyone queued up anymore for questions, so I will turn it back to Jorge and Saúl for some closing remarks.

Jorge Rada: Thank you very much Melanie.

Just a summary, we are going through a situation at the moment in the industry that is not particular to GIS or Draxton that is a little bit difficult because the prices are going up and the volumes are going down, but we are cautiously optimistic that this quarter, the fourth quarter, we start to see a change in tendency so during the next year volumes are going to go up, prices of scrap will stabilize and energy prices, we see the light at the end of the tunnel, because we see forward prices of maybe half of the prices that we see today starting on the second quarter of next year. Based on those factors, we see a much better 2022 and what is more important is that the fundamentals of the business are good, and we have won this year 115,000 tons volumes or program that we will launch in the next 24 months globally so

that's very good news and based on that we are continuing with our investment programs. We are very optimistic for the medium and long term, about Draxton, Vitromex and Cinsa

Saúl…

Saúl Castañeda: Thank you Jorge. Thank you for those closing remarks 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.

Melanie Carpenter: Thank you, everybody, you may now disconnect, have a good day.

Investor Relations Contact
Arturo Morales
ir@gis.com.mx
http://ri.gis.investorcloud.net/