International Conference Call
TUPY S/A (TUPY3)
2Q23 Earnings Results
August 15th, 2023

Operator: Good morning and thank you for waiting. Welcome to the conference call for earnings Q2 2023 for Tupy.

All the participants are connected only in the listen-mode only and later we will have a Q&A session when further instructions will be supplied. If you need any help from an operator during the conference call, please dial *0. This conference call is being recorded. The company would like to remind you that this event is also being transmitted simultaneously through the Internet via webcast. You can access at www.tupy.com.br/RI where you will find available the slide presentation. The slide selection will be controlled by the participants.

Tupy clarifies that any declarations made during this conference call concerning the business perspectives, projections, or operational and financial goals concerning the company's business are forecast based on the expectations of the management in relation to the future of the company. These expectations are highly dependent on the conditions of the domestic and international markets, the economic performance of the country and of the sector, therefore, they are subject to change.

We have with us, Mr. Fernando Cestari de Rizzo, CEO, Mr. Rodrigo Cesar Périco, CFO, and Hugo Julian Zierth, Investor Relations Manager.

Mr. Fernando, you may proceed.

Fernando Rizzo: Thank you and good morning. I thank you all for participating in our conference call.

In this quarter we are through with another part of the process to building new Tupy. We had also many unfavorable elements, a Brazilian market severely affected by the highest price of vehicles, Euro 6. This scenario had an impact on new and used vehicles. The export market light commercial vehicles were affected by restrictions in the supply chain, and they will become normal in the next few months. The drop in global sales volume of the company without MWM was 7%, especially in machining and assembly of engines for the South American market. This represents a drop superior to R$170 million in comparison with Q222.

We're also having, for example, the 12% higher price of the Mexican peso, which represents 20% of the total cost of the company. Also, we gave priority to cash generation and expenses to capture synergies to reduce fixed. Well, we have relatively low sales, we produced even less than we sold, and this led to a lower dilution of fixed costs, but we reached a strong cash generation in the period.

All these elements affected the margins and the EBITDA of the quarter with a negative impact of R$100 million in comparison with Q222. Most of this value will be recovered in the next quarters.

On the other hand, we have our actions foreseen in our synergies plan with many actions from the combination of the casting plants, expense reduction in fixed costs, renegotiation of contracts with suppliers and clients. These are initiatives that affect the company's business and have a positive impact on result and will have even greater results as of Q3.

We still operate with the structure that is greater than the one that we have, and it brings opportunities to have gains in efficiency. The resilience of our business model and the continued execution of our strategies brought benefits, which attenuated these factors. Net revenue for the quarter reached R$3 billion, 17% higher in comparison with the previous year. The adjusted EBITDA in the period was 322 million with a margin of 11.2%, identical to that of Q1 which also included the operations of MWM. We kept the profitability even in a scenario with an unfavorable exchange rate. When compared with Q1 23, this Brazilian currency appreciated by 5%, and 68% of the billing was in dollars or euros.

Net profit reached 62 million with an impact from financial expenses also related to the stronger domestic currency real versus the previous quarter. And also, we had a tax contingency of 66 million. This is a change due to a court process when we included Tupy Fundições in 2007. Excluding this non-recurring effect, net profit would be 128 million.

On the next slide we show the result of the actions to reduced cash conversion that we mentioned in the last quarter. We adjusted purchasing volume, and we suspended some operations, which helped with the inventory of raw materials due to clients' stops in previous quarters. With this, we reduced our inventory by 8% in relation to the previous quarter, a drop of 5 days. These stops, as expected, had an impact on the EBITDA of the period and contributed for a strong operational cash generation, which reached 159 million in the quarter versus 132 million in Q1.

We will continue with this strategy to reduce working capital and we hope to have a good cash generation during the year based on efficiency gains and price increases.

Now to talk about the main indications of the process, I passed the floor to Mr. Rodrigo.

Rodrigo Périco: Thank you, Fernando. Good morning. The revenues in the quarter had an increase of 17% when compared to the same period of the previous year, reaching 3 billion, including the results of MWM. In relation to the distribution of revenue per geography, 45% had an origin the USMCA, 34% in South American and Central America (especially Brazil), 19% in Europe and the 2% remaining Asia, Africa, Oceania. 88% of the revenue come from business in structural components and manufacturing contracts. These are cast iron products and value-added services, such as machining and also assembly of components. 5% of the revenue come from energy and decarbonization, for example, generators, generator sets, engines that are manufactured by us, ocean applications, lighting towers and products linked to decarbonization. And 7% from distribution, which includes aftermarket parts from MWM and hydraulic products.

The revenues coming from structural components and manufacturing contracts suffered an impact due to the drop in production in the Brazilian market due to a change in technology in engines, Euro 6, and price increases in the first semester of 2023, and also, macroeconomic factors such as high interest rates and restrictions to access to credit. Also, the revenues of the export market had a growth in all the applications with a highlight to commercial vehicles. Now the value-added products in revenues totaled 37% in this business unit.

On the next slide, we see the performance of energy and decarbonization coming from the acquisition of MWM and which includes generators sets, engines manufactured by MWM, also maritime products, ocean products, lighting towers and products related to decarbonization. Generator sets have suffered an impact due to a drop in demand as a consequence of high interest rates and restrictions to credit, also lighting towers and vehicle transformation, although they represent, little had an expressive growth in the comparison with the previous quarter. The revenues from this segment represented 12% of total sales for the domestic market and 2% of sales for export market.

Now distribution. On this slide, we will see the distribution unit, which includes parts aftermarket parts from MWM and hydraulic products. This segment represents 15% of the revenue in the domestic market and had a growth of 150% due to the inclusion of the results of MWM. The sales, the export sales increased 53%.

Now the next slide. We see the cost of products sold increased 22% in the annual comparison with an impact by the operation of MWM, the appreciation of the Mexican peso, and smaller dilution of costs and expenses due to the lower volumes. The operational expenses had an increase of 2% in relation to Q222 period, which did not include the expenses of MWM. With the same comparison base, including MWM, we see a drop of 8% in comparison with Q123, due specially to commercial negotiations for lower freight prices.

Now on slide 11. Adjusted EBITDA reached 332 million in Q223 and the margins in relation to revenue reached 11.2%, similar to that presented in Q1. EBITDA that was affected by factors that had relevant impacts, such as reduction in volumes due to the performance of the domestic market, and initiatives to improve working capital, and also, the appreciation of the Mexican peso as a result of production costs. These were mitigated by many initiatives to reduce costs and expenses and also to gain efficiency gains due to synergies already made.

Net profit reached 62 million with an impact from the stronger real in relation to Q223 in foreign currency generating financial expenses of 40 million versus a revenue of 36 million in Q222, and due to the non-recurring effect of an accrual or provision for a tax contingency with an impact of 66 million. Excluding these effects, the net profit would be 128 million.

On the next slide, I will comment on the financial results of the period. The increase in financial expenses is due especially to the greater gross debt due to debentures worth 1 billion for the payment of the acquisition of MWM, and also, the higher CDI, which impacts the interest rates of the loans in reais. Financial revenues reached 22 million due to the increase in the cash balance in reais and the interest rates that are paid for our investments. The results with exchange variations in the expense were 40 million. The effect of the appreciation of the real is 59 million, mitigated by the gains in hedging operations worth 19 million.

Here we see the main working capital accounts. Accounts receivable had an increase of 2 days due mainly to the higher volume in sales and commercial negotiations, which were partially mitigated by the stronger Brazilian currency and also accounts receivable in foreign currency, which represented 75% of the total. Inventory had a reduction of 5 days. This is due to the company. In accounts payable, we had a drop of 190 million due to the higher volume produced and actions to reduce inventory, which contributed for the drop in the amount of purchases in the period. This line was also impacted by the exchange rate on accounts payable and foreign currency, representing 43% of the total.

Now going on to the next slide, our indebtedness. Our net debt on June 30 was 2.2 billion, 1.8 times the EBITDA to considering that we are considering only 7 months of the EBITDA MWM. Our obligations in foreign currency represented 55% of the total, in relation to cash 54% were in local currency. We closed the first semester with a comfortable cash position of 1.2 billion.

Now I'd like to pass the floor to Fernando, who will make his final comments.

Fernando Rizzo: Thank you, Rodrigo. Going on to the next slide in the domestic market, we see many unfavorable factors that led to a drop in the truck market. We hope to have a recovery gradually in the next quarters. In the export market, a strong demand for trucks and heavy machines. Also, we had bottlenecks in the production chain. Now our main source of value is inside Tupy, as we will see in the next slides.

In the next slide, with the acquisitions made, we built a unique positioning in the market that allows us to capture opportunities from outsourcing and nearshoring. We announced in Q1 relevant contracts worth R$650 million. Yesterday we highlighted new manufacturing contracts. The first to supply heads that are totally machined and erected allowing a large OEM to acquire the parts locally in Brazil. The heads will be used in 13-liter engines in extra heavy trucks.

Another commercial agreement linking manufacturing contract and aftermarket has focused on the complete process of manufacturing short blocks, including casting, machining, the Assembly of the flywheel and also pistons, apart from the supply in components. This will be trucks for the US market, Canadian market, Mexican market and Colombian market.

These new contracts materializing new positioning of the company and show the trust of our clients in this business model.

In energy and decarbonization, we are advancing with large players in agro business to substitute diesel engines for biomethane engines and also biogas plants and energy generation using urban wastes and Agri business wastes. And we announced an agreement with Oxy Marine, from Sweden, bringing the first diesel engines for the Brazilian market.

On the next slide, we see our initiatives of synergies and a drop in costs and expenses in our operations, which brought us gains that on an annual basis are higher than R$150 million.

In purchasing, the new scale has allowed significant gates, the improvement of indicators has happened in an adverse scenario. We are ready to really sell higher volume, which was affected by the lower demand for commercial vehicles in Brazil and other segments abroad, which are suffering pressure. This effect on fixed costs was higher than 30 million and will dilute when demand recovers or adjust. We are preparing the company to advance in optimization and manufacturing, reallocating products for the plants with better structure and also giving priority to lower cash cost.

We continue working on recycling of batteries, hydrogen and new technologies for clean fuels and decarbonization in Agri business, and inventory management will help us to have a better profitability and cash generation. Also, some recognition from our efforts in innovation and sustainability; for the second consecutive year we were one of the highlights in the best ESG company of Exame in the category Capital Goods. And also, Tupy is one of the most innovative companies according to Valor Econômico, gaining 100 positions in the last two years.

I thank you all for your presence and now we will begin the Q&A session.

Question and Answer Session

Operator: Ladies and gentlemen, we would like to begin the Q&A session. To ask a question, please dial *1. To remove your question from the queue, please dial *2. This conference call is exclusive for investors and investment professionals.

Our first question comes from Luiz Gapsano, Itaú. Sir, you may proceed.

Luiz Gapsano: Good morning. Congratulations for the results. Concerning heavy vehicles, we have been following the results. Do you believe there will be any visible improvement in Q3? We know that efforts are being made, we haven't heard from anyone a sign that manufacturers have arrived at a price for Euro 6 engines. Do you see any stronger evidence, or will we have to wait more? Do you believe we will have anything new, a detailed view in Q3?

Also, from now onwards, you suffered this impact from OEM stops. What can we expect in Q3? Will you have more synergies? So, we want to know what kind of margins you expect in the future. Thank you.

Fernando Rizzo: Good morning, Luiz. Thank you for the question. First, concerning trucks, what we are seeing is a production level annually 110.000-120.000 trucks in the next few months, 9.000-10.000 trucks per month. Trucks and buses together. This is what we have heard from many of our clients, and it is lower than last year's numbers, but represents an improvement in relation to the first semester of this year.

We tried to monitor this. We have clients that work with inventory. We have clients that work with inventory, we have clients that work with orders from large truck OEMs. So, we're trying to monitor all of this, a part was sold, some clients have high inventories, but we've seen a reaction. We need a reference, Brazil has to replace a certain number of trucks every year, 100.000-110.000 trucks every year due to obsolescence of the old trucks. So, we always use this reference.

When we begin to see higher freight prices, we see trucks being substituted. Agro, for example, production going up, higher production, so we should need more freight in the country. The economy is growing, so we should see more trucks being sold. We're using an older fleet, transporters are being careful with their investments because of high interest rates, restrictions on credit, there is a relevant problem, to buy a new truck you need a good price for freight and cargo. Cargo, we have, there is cargo in the market, but they have to sell the truck, and the availability of credit for freelancers to buy these trucks so the fleet owners can buy new ones is small.

So, for every new truck, you sell two or three older ones are sold in the chain. So, the market is reorganizing itself and we should begin to see an improvement from now on. OEMs are reducing vacation, we see some announcements, there are some forecasts from Anfavea, Sindipeças showing that things are better than in Q1.

Now concerning the margin curve, it's important, we tried to explain, we did a lot, these are things that are being built based on synergies of the acquisitions we made in the last 18 months, and they are now becoming a reality. Now, if we have a sudden exchange variation, the impact is very strong. So, it's very difficult to make forecasts with such a sudden impact in exchange rates. We have some contracts that protect us, but it takes some time. For example, it takes times to increase prices in the short term, but it takes some quarters to recover.

So, when you have a sudden change in the exchange rate, for example, the Brazilian real became 5% stronger, and in total, 12% difference in the exchange rate and the revenue from Mexico is all in dollars, so we felt an immediate impact on the operation due to the appraisal of the Brazilian currency. So, the company continues to be built, we have 35% of our sales from the acquisitions, we made acquisitions with attractive multiples and we are now organizing this, it takes time, it is being done and it's important, you can see these effects in the numbers and how the exchange rate affected our corporate results.

We sold less and we had an unfavorable exchange rate with a strong impact on immediate results of the company, and most of this is recovered with many activities increasing efficiency, actions that help to recover most of this. But we still have things to do, we are restructuring, adjusting plans, contracts, purchasing.

So, we try to show to you our perspectives in the medium term. We are now integrating different companies and we were affected by this scenario. So, much more than traditional Tupy. So, with all these factors, we are working to recover, but if we maintain the same macroeconomic factors of the previous quarters, we would have had a much better result.

Luiz Gapsano: Thank you, Fernando.

Operator: Our next question, André Mazzini, Citibank.

André Mazzini: Hello, Fernando, Rodrigo, thank you for the call. The first, a follow-up of this point. The effect of the Mexican peso in this quarter. so, you have you a mismatch, I believe you have hedging for financial results. Could you talk more about the hedging and the correlation with the peso and whether you will change the prices?

The second, more color on the problems in the supply chain. Where did the problems happen? Engines or powertrain, transmission? And will this continue in Q3?

Fernando Rizzo: OK, André. I will begin then Rodrigo can supplement. I will begin with the second, the supply chain problems. We had one very large client that made inventory adjustments, they reduced their operation, and another large client of the company in the US that they had a problem with another component in the vehicle, and because of this they had to restrict production for many weeks. And one product from one client, but they were relevant for us and caused this effect in the supply chain.

Concerning the Mexican peso, for example, these operations in Mexico, we have our contracts. What happened? There was a strong inflation in Mexico, you have to raise salaries, everything, and apart from these 7% as of 1 year, I used to receive 20 pesos for each dollar, now I received 17 pesos for each dollar, and this effect is very strong on our results and in the EBITDA.

When you have a drop in sales, if I don't reduce, I lose a relative EBITDA, I lose revenue and 7%. When the effect is on the exchange rate, the impact is stronger. So, our contracts are long-term contracts with the clients, we have mutual investments in tooling, and we have contracts where you recover these exchange variations, but this is not immediate, it happens gradually, it depends on many combinations between exchange variation and manufacturing.

Rodrigo can also comment.

Rodrigo Périco: Hello, André. Supplementing, yes, we have protections, we have contract clauses, and concerning hedging, the company, yes, has hedging for all the currencies. Now in Mexico, as mentioned, we have most of our cost in Mexican pesos, Dollar is the official currency, and we work through a hedge in cash flow. So, this is not recognized in the operational result. You see some benefits in financial, in the lines covering financial issues.

André Mazzini: Thank you.

Operator: Our next question is from Andressa Varotto, UBS.

Andressa Varotto: Good morning, Fernando, Rodrigo. The new contracts that you announced, can you give us an idea of impact of these contracts, also distribution? With these new contracts with MWM, what are the opportunities that you see in distribution?

Fernando Rizzo: Excellent question, Andressa. Well, the two contracts together represents R$50 million per year. They involve machining and assembly for demand in Brazil, heavy trucks, and it has better margins because it has a lot of added value, and we will use existing capacity in MWM and Tupy. We will need investments, but we will be using existing CapEx.

On the other hand, concerning distribution, another project we announced has to do with distribution and aftermarket. What does this mean? We will be using, we will be sending to the US machined engine blocks with flywheel, pistons and rods. So, it's a pre-assembled component, it's a contract for aftermarket, it's not for supply to production lines.

But this is our objective. For example, we have one container with US$50,000-60,000. If we export the blocks with machining and preassembly, we have very competent companies in Brazil supplying these things for us, like Male and Bosch, then we have a better competing capacity, we will deliver this product to the US, Ford dealerships in Canada, Colombia, Mexico and the US. The meaning of this, this is an important message, concerning distribution MWM adds value, and this was not well-recognized because we acquired the company that had a large service network in Brazil with trained employees, they have a strong capillarity in Brazil, and they also had the engines.

Now, they are very talented, they know the business, we're expanding this chain of services for many other engines of other brands too and using the existence of the distribution network that MWM has with all the capillarity and naturally we want to migrate to higher value-added products. so, for example, in the US market, you have remanufactured engines, you have an intermediate chain that produces these remanufactured engines.

Clients need speed. Some components, it takes a long time to disassemble, so you can give them a ready engine, remanufactured engine. So, we're making progress, the idea is to build offering more components, our portfolio is limited, we want to include more components and work with higher priced products. And this is a characteristic of the US and European markets; pre-assembled engines, pre-assembled components and you have a faster turnaround for the fleet owners.

So, we're investigating alternatives to know who the partners are that we can use, sometimes you remanufacture engines and leave it on the shelf and when the clients need, they gain speed, and we can do this through the distribution chain that MWM has.

So, we don't have forecasts when we will be able to do this, but these are our plans, this is our strategy.

Andressa Varotto: Thank you.

Operator: Our next question, André Ferreira, Bradesco BBI.

André Ferreira: Good morning. Congratulations. Thank you for the question. We know your casting capacity, but how is the capacity at MWM to assemble engines? Do you need to increase the capacity at MWM? And also, the plants in Portugal, Betim and Aveiro, what kind of EBITDA margin do you expect from these plants in Portugal?

Fernando Rizzo: Well, first, concerning the assembly capacity, MWM has a lot of capacity, it was the largest producer of diesel engines in Brazil in the past, part of this capacity was removed, there is a plant in Canoas, in the South, that no longer exists, so the capacity was reduced at MWM, so there is capacity for some products with certain characteristics, there is some surplus capacity, for example, heads for Euro 6 and the Brazilian market. so, these will use the existing capacity.

This is gradual, it depends on the deals we close because we're looking at all the alternatives. So, for example, most of the construction machinery in Brazil has imported engines. Most of the pickup trucks have imported engines. So, we're looking at this and the services we can render, engines depend on many tests, emissions and so forth to make these engines. We have this capacity, we have a strong engineering team, and they are focused on biofuels, biomethane, biogas, hydrogen, ethanol.

So, we will have a Tupy Day when we will clarify all these points. So, we're working in this direction, we're building the company in this direction with a country that will use multi fuels and we have to be prepared for this. So, the company has a strong expense to develop batteries, hydrogen, to preserve the engineering team because we have a strong position, we understand the needs in Brazil, and yes, we will benefit from many trends, for example, outsourcing new fuels.

Concerning margins, we have a standard in the last few years. We believe that we will raise Teksid to this standard and with this combination we should be better than the previous standard. We're not there yet, this is the plan, the strategy, we already did 40% of what we have to do. The great value will come when we transfer products. We made many investments during these 18 months and from now on, as of Q2, we will begin to exchange products between the plants.

Until now, they were independent, they did not exchange products among plants. Now we have all the teams, all the management integrated with Tupy. But we believe that there is a journey for some quarters to reach the potential.

André Ferreira: Thank you.

Operator: Our next question Igor Araújo, Genial Investments.

Igor Araújo: Thank you. Congratulations for the results. Concerning the synergies of acquired companies, now in Q3 and 4, we see that even with an adverse scenario we have an improvement in the margin, EBITDA margin. looking at commercial vehicles in Brazil, we see a strong growth. Is this due to the recovery of heavy vehicles?

Fernando Rizzo: Hi, Igor. Thank you for the question. What you see in sales doesn't mean that we delivered those products to the clients in that period. When you look at the forecast we had, Anfavea, Sindipeças, our forecast we were expecting a better market this year, the pre-purchase was much smaller than when we had the change to Euro 5 engines, pre-purchases were smaller this time. The company was prepared for higher volume, we had to stop the company, reduced production to favor cash generation. So, in the comparison, the best comparison we're trying to give to you is truly to look at the exchange effects, exchange rate effects, variances in sales and a much smaller production than we had in Q2 last year.

And when you have a lower production, you produce more for inventory, so I have to absorb the fixed cost of the company in this quarter, I transferred part of the fixed cost to inventory and with this I maximized the margin of the period. So, there are many combined effects. I was talking to the team, if you look at all these effects, our results would have been worse. There were other effects from synergies that helped us to reach the 330 million.

And once again, the exchange rate affects much more the results than the changes in sales. It was 7%, that's R$162 million that I did not sell. Now, when you have the exchange effect, the result dropped 5%, appreciation of the local currency in Q1 68% of our revenue in US dollars, this has a great effect. So, this is the challenge when you have sudden changes. That's why we consider that we would like to do more, and the result is reasonable when we look at the difficulties we had in this quarter.

Igor Araújo: Thank you.

Operator: Our next question will be from the web, Alexandre, investor:

“In spite of the scenario – congratulations for the result –, with a more conservative management in working capital, will you be ready to avoid losing sales if the market recovers? What is your experience?”

Fernando Rizzo: Thank you, Alexandre. First, in the case of Primato, we received the licenses now. Yes, it's a project that should scale a lot in Brazil. I like to highlight what this means; it's a project for 60,000 heads of pork that could produce 6,000 liters of diesel per day. This is the energy Brazil is throwing away. We have 23 million heads of pigs/pork, and they can generate 6,000 liters of diesel, not actually diesel, but biomethane, which can be used as energy that can be converted to gas for industrial operations equivalent to 6,000 liters of diesel, and this can also supply the trucks with engines designed by MWM using biomethane.

Yes, this project should scale, we see an interesting economic return and it generates benefits for all. So, this is a solution for a serious problem because it contaminates rivers, it can contaminate underground waters. So, we're transforming these residues from pork into biomethane with clean energy.

Now the recovery of the market, we're prepared. We had a higher inventory because last year we had many sudden drops, stops from clients due to lack of components, and we don't receive this information sometimes on time and it's difficult to decrease production. And we have many workers, many employees, so we have been planning production, we are prepared for a recovery in sales, we hope it will come, and if God wills, we will be able to sell much more.

Operator: Thank you. Our next question is from Marcelo Mota, JP Morgan.

Marcelo Mota: Good morning. First, a follow-up on margin. We know the main effect was the exchange rate. In Brazil, the exchange rates has its ups and downs. This margin recovery prices and costs take time. The exchange rate was well below R$5 to a dollar, now it's back to 5. So, what are your expectations for Q3-Q4 in terms of the exchange rate? Volumes we believe will improve.

And the second question, concerning cash generation, in transportation and generation, you did the work to preserve capital, and now do you believe we will have the same results in the Q3?

Fernando Rizzo: Hi, Marcelo. Thank you. We have contracts that have clauses concerning exchange rates, exchange variation by quarter, by semester or annually, so it's not for 100% of the portfolio. If you look at this historically, we worked with an exchange rate of R$2 to a dollar in the past, now it's 5. Yes, contracts protect us. Concerning cash generation in Q3, it's important to say in an ideal scenario, the next quarter will be stronger with all these expectations of sales. If we don't obtain these sales, we will monetize our inventories and this was mentioned in other calls, we have an adjustment now to be paid according to negotiations for the payment of MWM 200 million, and this cash came from the operation.

So, yes, we expect something better in Q3, we have a solid cash position.

Marcelo Mota: Thank you.

Operator: Our next question, Lucas Lage, XP Investments.

Lucas Lage: Good morning. I'd like to know about capital allocation. Do you believe you will go back to the previous situation? Also, after the acquisition of Teksid, what is the focus of the company? Are you thinking of new acquisitions to supplement your product line? And also, any points about dividends? So, opportunities for capital allocation?

Fernando Rizzo: Hi, Lucas. Thank you for the question. When we look at the traditional company with Teksid in casting, yes, the project has the intention to reduce CapEx. We are reallocating products, and we should be increasing cash generation in the traditional business. But we built new strategies that we call "New Tupy" first looking at adding value. Adding value has an effect on CapEx, we announced these projects in Mexico with investments worth R$300 million for large projects, for machining and pre-assembly for the US market. These projects are in progress, and they will become revenue as of 2025. The projects are approved.

When we look at MWM, there is a demand for CapEx, for example, Primato project we have great expectations in terms of scalability, we're talking about wastes from the production of protein, we have generators, we're building projects with wastes from animal protein, there are other wastes we're working on, from cattle, we're also looking at carbon credits and other benefits that we can expect.

Yes, because we're converting methane, we're reducing the effect of methane and producing energy for society with a lower carbon footprint for products. When we talk about distribution, we're also studying alternatives to grow. We may talk about small acquisitions, but to supplement our products because an important focus is aftermarket parts with many opportunities, with our distribution chain, with MWM brand. And, yes, we're looking at this business.

Finally, we have the initiatives hydrogen, battery recycling where we should have an investment at the end of this year, a small investment, a small plant for battery recycling, and this is a project that can have potential and scalability. These are businesses, it's even difficult for us to define the size of the market. biomethane is a project for all of Brazil and may be also the US. Battery recycling will be very important for Brazil. We're trying to obtain a patent and they will also be important in the US and Europe because you recover minerals to build new batteries.

What I'm trying to say, we have a great portfolio of projects, the company used to have one business, now we're spending money to develop these new fronts. Yes, but all this energy transition, low carbon, there are many opportunities, but of course, we're studying all the alternatives, maybe with projects in the US, Reduction Act, we've seen also the Brazilian Development Bank giving support to these projects, and yes, we will take advantage of them.

It's difficult to tell you now. We have some demands for CapEx. We're very cautious with CapEx. We penalized EBITDA to preserve cash generation and also to manage our debt. We have a strong financial discipline, we're very cautious with finance, we're testing technologies and when we are sure we will announce new things.

It's difficult to talk about capital allocation now because it depends on the success of these fronts. But fortunately, we're very happy with the performance we have had until now. I'm sorry, I can't give you a more objective answer, but there are many things on the table and we're trying to see how we will allocate capital in the best possible way.

Lucas Lage: Very clear. Thank you.

Operator: We would like to conclude the Q&A session for Tupy. I'd like to pass the floor to Mr. Fernando for his final comments.

Fernando Rizzo: Well, I'd like to thank you all for participating. Both in relation to Q222 and this year, all these adverse events, like the exchange rate, our decision to produce less, really brought a difference in EBITDA of 100 million when you compare the quarters. This decision to monetize inventory, we're doing this since the beginning of the year, and this helped operational cash generation.

Some of these effects from the exchange rate will continue in the next quarters, the domestic market will recover. Yes, in the last two years we made acquisitions with interesting multiples and right now they correspond to 35% of our earnings, our revenue, and they are diluting for the time being our margins. But independent of these effects, we continue to go forward according to our business plan, and we will recover. We continue with synergies from acquisitions.

Apart from these synergies, we announced new businesses with higher margins that are higher than our average margins, and these results will come in 2024. This is machining, growth in aftermarket, biomethane, also plants, and decarbonization, and we continue investing in R&D and innovation with recycling of batteries, hydrogen, biofuels, and all of this means that in the next few years we will make progress in areas with higher profitability, diversifying the revenue and increasing cash generation.

Thank you. We wish you a good day.

Operator: The conference call of Tupy is concluded. We thank you for participating and we wish you a good day.