Microvast, Inc.
3Q21 Earnings Conference Call Script
November 15, 2021

Operator

Thank you for standing by, this is the conference operator. Welcome to the Microvast Third Quarter 2021 Earnings Call. As a reminder, all participants are in listen-only mode and the conference is being recorded. After the presentation, there will be an opportunity to ask questions. To join the question queue, you may press * then 1 on your telephone keypad. Should you need assistance during the conference call you may signal an operator by pressing * and 0.

I would now like to turn the conference over to Sarah Alexander, Microvast's General Counsel, please go ahead.

Sarah Alexander

Thank you, operator and thank you everyone for joining us today. Hosting the call with me today are Mr. Yang Wu, President and Chief Executive Officer and Leon Zheng, Chief Financial Officer. Shane Smith, Chief Operating Officer is also on the line and will be assisting with Q&A.

Ahead of this call, Microvast issued its third quarter press release, which can be found in the Investor Relations section of our website ir.microvast.com.

Please note that on this call, we will be making forward-looking statements based on current expectations and assumptions, which are subject to risks and uncertainties. These statements reflect our views only as of today, should not be relied upon as representative about views as of any subsequent date, and we undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements in light of new information or future events. These statements are subject to a variety of risks and uncertainties that could cause actual results to differ materially from expectations. For further discussion of the material risks and other important factors that could affect our financial results, please refer to our filings with the SEC including our Quarterly Report on Form 10-Q.

In addition, during today's call, we may discuss non-GAAP financial measures, which we believe are useful as supplemental measures of Microvast's performance. These non-GAAP measures should be considered in addition to and not as a substitute for or in isolation from GAAP results.

A webcast replay of this call will also be available on the Investor Relations section of our company website.

With that, I will turn the call over to Mr. Wu.

Mr. Yang Wu

Thank you, Sarah, and good afternoon everyone. I would like to start out by thanking our employees for their outstanding contributions to Microvast's success. I would also like to thank our shareholders for their commitment and our customers for their support.

The third quarter of 2021 was eventful. We successfully completed our business combination with Tuscan Holdings in July. The transaction raised $708 million in net cash proceeds to help fund our growth initiatives, including our ongoing capacity expansions in Clarksville, Tennessee and Huzhou, China. In addition, we already moved into our new R&D facility in Orlando, Florida.

We are pleased with the progress at all three of these sites, though it is a difficult time for construction projects given labor shortages, inflation and other challenges. We recently posted a time lapse to our social media accounts showing the progress of the construction of a new building on our campus in Huzhou, which we refer to as "Phase III." Once completed, this building will feature approximately 700,000 square feet of manufacturing space designed for 12GwH per year production capacity in total.

The first 2 GwH per year fully automated production line is under construction and planned to be completed at the end of 2022 to 1Q of 2023. I'm proud of the progress they've made in just a few months since the transaction closed.

In Clarksville, we purchased an existing building earlier this year and the renovations to make that building and utilities ready for our manufacturing are underway.

And in Orlando, our existing employees have already moved into the new facility and we are actively recruiting to expand our R&D team.

We continue to invest in R&D to ensure that our battery technologies remain on the forefront and we expect to announce two new products in the first quarter of 2022. We will have more information about these developments in our next earnings call.

Before turning the call over to Leon to review our financial results, I'd like to highlight a few key takeaways about Microvast:

We are new to the public markets, but we have been in business since 2006 and we are an established battery manufacturer and innovator.

We achieved revenue growth of 20% during the quarter and 43% year-to-date, each as compared to the same periods in 2020. This growth was achieved in the face of many macroeconomic and industry level challenges, including global supply chain disruptions, logistics challenges, increasing raw material prices, inflation and the ongoing COVID-19 pandemic.

Historically, our business was concentrated in Asia/Pacific; however, we are focused and gaining momentum with our customer base in Europe and North America. This momentum is evidenced by 53% growth in our forecasted contracted revenue – which grew from $1.5 billion in February 2021 when the merger was announced to $2.3 billion at the end of September.

When we refer to "forecasted contracted revenue," we are describing backlog plus management's estimates for revenue we expect to realize from existing contractual relationships with customers. To be included, we must have a signed contract in place, usually in the form of a framework or supply agreement. In addition, we have had advanced discussions with the customer about future volume requirements for the particular project or vehicle model. These contracts often include pricing and other terms and conditions; however, they do not typically include volume commitments.

We expect to realize current forecasted contracted revenue between 2021 and 2031.

We also saw backlog growth of 65% to $53 million from $32 million in September 2020.

We are pleased to see the global trends toward electrification continue in the United States, with the recent passage of the Infrastructure Investment and Jobs Act. The bill provides solid support for electrification efforts in the US, which we expect to increase our addressable market and accelerate our progress and opportunities in North America.

I'll now turn it over to Leon to discuss third quarter financial results.

Leon Zheng

Thank you, Mr. Wu.

Despite the many industry-wide headwinds we've faced, we grew revenue for the third sequential quarter. Revenue grew 20% this quarter and is up 43% year to date, each compared to the same period last year.

Gross loss was $35.9 million, compared to gross profit of $3.7 million in Q3 2020. The change was largely due to a $35.6 million product warranty expense accrual and a $6.6 million inventory write-down. In addition, increased battery raw material costs and a $2.3 million share-based compensation expense accrued following the business combination also negatively impacted our Q3 gross profit.

Before moving to operating expenses, I would like to provide more context on the warranty accrual. Most of the warranty accrual in this quarter was related to a legacy product sold to certain customers in China during 2017 and 2018. This legacy product experienced performance that does not meet our standards, leading us to perform a rigorous root cause analysis.

Following the completion of the root cause analysis in October 2021, we determined that the cause was a component sourced from a third-party supplier. We believe it is more likely than not that we will need to replace this legacy product during the remaining warranty period under the terms of the sales contracts. Accordingly, we accrued a $34.1 million one-time warranty expense related to this legacy product in the third quarter. The component was not incorporated into any of our other products.

If we exclude the one-time warranty expense accrual, the inventory write-down and the share-based compensation expense, the Company’s adjusted gross profit would have been $7 million instead of a $35.9 million gross loss during the quarter. This translates to an adjusted gross margin of 19%.

Operating expenses were $78.0 million compared to $12.7 million in the prior year period. The change in operating expenses was primarily due to a $56.0 million share-based compensation expense accrued following the business combination as well as increased headcount to support the Company’s planned growth initiatives and other expenses related to operating as a public company.

Finally, net loss was $116.4 million compared to a net loss of $10.1 million in the same quarter as last year. The change was primarily due to the reduction in gross profit and higher operating expenses, as described above.

Turning to our balance sheet. The business combination with Tuscan in July bolstered our cash position and Microvast ended the third quarter with approximately $612.5 million in cash, cash equivalents and restricted cash.

Finally, let me talk about our backlog and CapEx spending. As of September 30, 2021, we had backlog of $52.7 million, an increase of 65% from $31.7 million in the same quarter of last year. We are currently ramping up our production efforts to perform a majority of this backlog in Q4, which gives us confidence in reaffirming our 2021 revenue guidance. However, we are closely monitoring logistics, especially bottlenecks in international shipping.

Moving to CapEx – based on equipment delivery timelines and scheduling during the upcoming holiday season, the Company expects some of its previously planned capital expenditures for 2021 to take place in early 2022. Total capital expenditures for 2021 are now expected to be in the range of $120 to $150 million.

With that, I will turn it back to Mr. Wu to discuss our business outlook.

Yang Wu

Thank you, Leon.

As Leon mentioned, we are closely monitoring challenges in international shipping, but based on current market conditions, backlog, business trends and other factors, we are reaffirming our previous outlook, and continue to expect full year 2021 revenues to be in the range of $145 million to $155 million.

Additionally, as temporary supply chain headwinds dissipate, we believe we are well-positioned to capitalize in 2022 and beyond. We are in the middle of our budget cycle and expect to be able to provide additional clarity on 2022 on our next earnings call.

Thank you for your time today. I will turn it back over to the operator, who will open up the line for questions.

Operator

At this time, there are no questions in the queue.

Sarah Alexander

Thank you operator. At this time, we are going to move to questions submitted in response to our #askmicrovast campaign. We appreciate all of the questions submitted, however, given the volume we have received, we will focus on the most frequently asked questions.

#askmicrovast Q&A

Q1. [SARAH] By far, the most frequently asked category of question related to updates on specific customers or contracts. Now, Shane, I know we have non-disclosure agreements in place with almost all of our customers, in addition to a variety of other commercial and competitive reasons for not disclosing all of our contracts. What updates are we able to share with the investment community at this time?

A1. [SHANE] Thanks Sarah. We are sometimes able to negotiate with our customers to make public announcements about specific projects or partnerships, but not always. What we can tell you is that our forecasted contracted revenue has grown significantly since we announced the business combination in February 2021 – it is up 53% from \$1.5 billion to \$2.3 billion. So I think that growth demonstrates that we are continuing to be successful at winning new multi-year framework and supply agreements with leading OEMs and discussions and testing with many others are ongoing. And we do hope to be in a position to provide some additional details about new and existing customer relationships in the coming months.

Q2. [SARAH] Mr. Wu, are you able to elaborate on the plans for the new R&D facility in Orlando?

A2. [MR. WU] Yes, Sarah. Microvast is a fully vertically integrated company. We make materials, battery cell, battery pack, battery system, from the top to the bottom. And our R&D center will do the same to support our growth. We will explore the whole spectrum of technologies from battery material to battery cell, battery pack, battery management. Our mission statement for the research center is to create excellence to power the world.

Q3. [SARAH] We also received a lot of questions about updates on our capacity expansions. Are you able to add any additional color on this Shane?

A3. [SHANE] Sure. Our capacity expansions are underway, and we expect CapEx to increase in Q4, as implied in the guidance we provided in the press release.

I would like to go through each one of the facilities real quick. In Huzhou, as Mr. Wu previously noted, we're constructing a new building on our existing campus. We're ordering enough equipment to support 2-gigawatt hours of capacity per year. But the building is designed to support 12-gigawatt hours, though we will need to add to the utility infrastructure. So the building is coming along, and we're in the process of ordering the equipment right now.

In Clarksville, we purchased an existing building. We're in the middle of renovations to make the layout of the building suitable for our needs. Again, the initial capacity will support 2-gigawatt hour per year, but the existing building and utilities will be designed for 4-gigawatt hours so we can rapidly respond to customer demand. And additionally, there's enough space on the existing land to add an additional 4-gigawatt hours to support future customer demand, giving us a total potential capacity of 8-gigawatt hour at the Clarksville facility.

Our Berlin facility is operational already, able to ship to customers today.

So overall, plans are progressing nicely. We're looking forward to completing these projects to meet customer demand. We believe we will realize some nice efficiencies with some of the new manufacturing equipment we order, including a higher level of automation, resulting in less headcount.

[SARAH] Ok, I think we have time to cover one more question from our retail investors.

Q4. [SARAH] Mr. Wu, a few of our investors have requested additional clarity with respect to Microvast's plans in the passenger vehicle market.

A4. [MR. WU] Our main focus right now is on commercial vehicles. On the passenger vehicle side, we believe many of the large car manufacturers will eventually bring battery manufacturing in-house. We intend to support them as a material supplier, in particular on the components side and we can also license technology.

Thank you, everybody.