KION GROUP AG

Q3 2017 Update Call

Conference Call Transcript

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Dr Thomas Toepfer (CFO)

Gordon Riske

Thank you. Yes, welcome to our update call for Q3 2017. Following last week's publication of our preliminary financials and adjusted outlook, we will be presenting today the detailed and final results for the third quarter of this year 2017. These are unchanged to the preliminary results. As a basis for this call, we would like to use our Q3 2017 presentation. It's available on kiongroup.com under Investor Relations in the presentation sections.

As usual, we will be presenting four parts today during the call, and we will then open up, of course, for discussion and for your questions. I'll begin with the strategic and financial highlights of the last quarter, followed by a market update. I will then hand over to our CFO Thomas Toepfer for the financial update. And then we will conclude with an adjusted outlook for the full year 2017.

So I'm on page three at this point, where we have summarized some of the strategic highlights for Q3 2017. At the beginning of September, Dematic signed a global agreement with AutoStore. AutoStore is a provider of modular piece-picking systems located in Norway. The agreement with AutoStore will enable Dematic to expand its omnichannel integrated solution offering with an ultra-high density storage and goods to person piece-picking system to optimize order fulfillment and kitting.

Dematic will design, configure, engineer and install and support AutoStore as a subsystem within an overall Dematic solution around the world. So it's a global agreement. Adding AutoStore to Dematic's comprehensive suite of solutions enables our customers to obtain the ideal storage, buffering, and piece-picking solution.

Also in Q3, we announced the market launch of the Linde lithium-ion battery trucks with 2- and 3-ton load capacity. This represents a significant expansion of our portfolio of lithium-ion-driven industrial trucks. Sales of the first counterbalance trucks with lithium-ion 90-volt versions have just begun, featuring load capacities of 2, 2.5, and 3 tons. These trucks combine low maintenance, long life, and energy-saving batteries with driving and lifting performance.

On page four, I'd like to summarize some of the financial highlights for the third quarter 2017. With our Q3 preliminaries that we published last week, we reported Q3 financials and lowered the outlook for KION Group slightly. The outlook for our industrial trucks and services segment, however, was increased to reflect continued strong momentum in this business, whereas the outlook for our supply chain solutions segment was adjusted slightly downwards to reflect the lower-than-anticipated run rate in the first nine months of this year.

On the top line, we saw order intake and revenue growth to about €1.8 billion in the quarter. The IT&S, our industrial trucks and services, business saw continued growth at a more normalized level. The SCS segment, our supply chain solutions business, saw hesitation to invest and delayed project decisions by its customers.

Regarding our profitability, our adjusted EBIT margin improved to 10.5%. This is significantly above the strong previous-year level of 9.9%.

Compared to June of this year, net financial debt remained unchanged at €2.3 billion, and we generated a free cash flow of €120 million in the first nine months of this year, driven by our operating performance. This compares to a free cash flow of €65 million in the same period of the previous year.

Moving to the market update, starting on page six, focusing on the industrial trucks, it shows the global market development by region. Overall, the global market maintained a steady growth in the third quarter. Western Europe showed a continued momentum with growth of 8.9%, so another pickup in the third quarter. Eastern Europe showed again a positive development, growing 14.1% with slight normalization in some smaller markets, but overall very strong in Eastern Europe.

China, very strong growth with orders growing by 39%, driven among others by the continued government spending, resulting in strong demand for economy entry-level IC trucks.

North America declined slightly by 0.9% in Q3 due mainly to comparables in the warehouse segment last year. IC and electric trucks continued to grow nicely.

South and Central America stayed on a recovery course with about 32.4% in Q3 2017. So as a result, if you look at all of the regional developments together, a very solid continued growth of the global market at 15.5% in Q3 2017.

Looking onto page seven, breaking down KION's growth by region, in Western Europe, KION saw very good growth, above the market again in the third quarter. Eastern Europe, KION grew steady, very much in line with the high-growth market.

In China, we saw a very good quarter, even though it lagged the market. As you know, we are focusing primarily on more premium products in electric and warehouse. And the biggest part of the market grew heavily in the segment of IC economy trucks.

North America, Q3 very solid after exceptional growth from new product introductions that we had in the previous quarter.

And also South and Central America, we remain focused on profitable growth, especially in an extremely competitive market, which has gotten much smaller over the past quarters, the Brazilian market.

Overall, KION saw, again, a very good quarter with global growth of 11.3% in the third quarter, benefiting from continued strong global market. And we had an order intake in total of 45,300 trucks.

With this, I'd like to hand it over to our CFO Thomas Toepfer, who will present the financial update.

Thomas Toepfer

Well, yes, thank you very much, and also a very warm welcome from my side to our presentation. I'm on page nine of the deck, and here, you see the key financials for the first nine months of the year. Let me start on the left-hand side. As you can see, the order intake saw strong growth to €5.7 billion, and the order book stood at €2.2 billion, and that is at the same high level as at year end 2016.

If you look at the revenue, that number also grew strongly to €5.7 billion. And I should mention negative FX translation effects that were €26 million and €27 million, respectively.

If you look at the adjusted EBIT, that number grew to €562 million, and that represents a margin of 9.9%, so clearly above the previous-year level. And this is despite some significant material cost headwinds and also, as I said, FX transaction effects that we were encountering.

If you look at the right-hand side, you see the net income with €230 million, also strongly above previous year, despite the PPA effect that comes from the Dematic acquisition, so that overall, I would say we saw continued strong and profitable growth in the first nine months of the year.

If you turn the page to page 10, you see the same set of numbers for Q3. And again, you can see that the order intake grew by 39% to €1.8 billion, revenue also up to €1.8 billion, and that's a growth rate of 44%. And the adjusted EBIT grew even faster to €195 million. And therefore, you see another uptick in margin to 10.5%, so significantly above the Q3 2016 again, despite material cost headwinds and FX transaction effects that we were encountering.

And on the very right-hand side, you see the net income with €80 million, also a strong increase relative to previous year despite, as I said, the PPA effect from the Dematic acquisition that had an effect here. So overall, we saw also a strong set of results in Q3 with improving margins despite the headwinds that I was alluding to.

If you go into the individual segments, please turn to page 11. You see the numbers for our industrial trucks and services segment, both for the first nine months of the year and also for the individual quarter. If you look at the middle of the page, you see the numbers for Q3, and the order intake grew by 5.2% to €1.4 billion in the quarter, revenue also up 6.2% to €1.3 billion, with the new business growing at 5.4% and the services grows at 7.0%.

If you look at the adjusted EBIT, that number's also up by 6.1% to €153 million. Again, that represents a margin of 11.5%, higher -- at the same high level as the last year, however, despite accelerated headwinds on the material cost side, especially related to steel and rubber as well as FX headwinds related to the British pound transaction effect. So we maintained our very high margin at the same level as last year. And as we said in the beginning, we saw a more normalized growth pattern but continued at a stable high margin in the IT&S segment.

Please turn the page, and you see the same set of numbers for our supply chain solutions segment, again for both the first nine months of the year and Q3. If you look at the middle of the page, in Q3, the order intake stood at €493 million. That was actually higher than in Q1 and Q2 of this year, but it was lower than we had originally anticipated. And we'll come to that in a minute.

The revenue was at €514 million in Q3, and more than half of that was generated in North America. And the adjusted EBIT was at €59 million, and therefore resulting in an adjusted EBIT margin of 11.4%. Again, that's a clear margin step up. And that shows that we're benefitting from a good project mix and also the fact that the Monterrey ramp up is progressing according to plan. So I can confirm again that we're on track to complete the ramp up of that factory during the course of this year.

If you turn the page to 13, you see the reconciliation of our numbers all the way from the adjusted EBITDA to the net income for the group. And I would just like to pick some selected items and comment those. First of all, the nonrecurring items, as you know, result mainly from expenses relating to the integration costs for Dematic and the Monterrey ramp up. And we continue to implement the measures as we defined them at the beginning of the year for the ramp up of the factory. So we think, as I said, we will be successful to be on track with this in the course of the year. And secondly, our guidance for the NRI is relating to the SCS segment, which is between €20 million and €40 million for the entire year, remains unchanged.

Secondly, if you look at the PPA items with €139 million for the first nine months, those relate mainly to Dematic. And thirdly, I would like to comment on the net financial expenses, as you can see, that despite the higher net debt compared to Q3 2016, our net financial expenses are improved by our optimized financing structure following the capital increase, which we did in May, and also the refinancing in February of this year.

Last but not least, let me highlight on the very bottom of the page the EPS are significantly improved despite the capital increase that we did.

So please turn the page to 14, and you will see all the details for the cash flow. And as usual, I will start with the last line item on that page. And you can see we had a strong free cash flow to the firm of €120 million for the first nine months of the year. And that is obviously before interest payments.

The key drivers were, as you can see in the first line, a higher EBITDA as a result of our strong operating performance and the -- and due to the Dematic integration, our net working capital definition now fully reflects the project nature of the supply chain solutions segment, just as a reminder and as you can see in more detail on the box on the right-hand side of that page.

With that, let me come to the development of the net debt or in general the debt structure of the business, and you have that on page 15. On the very left-hand side, you can see the net financial debt, and that remains essentially unchanged at €2.3 billion relative to June 2017. And this represents a financial leverage of two times. Again, that number is also unchanged relative to the numbers that you saw three months ago.

Similarly, if you look at the middle of the page, you see the industrial net operating debt. That number also is pretty much constant at €2.7 billion, with a respective leverage of 2.6 times. And as we have already said many times, our ambition is and our target is to reduce this leverage further to around two times over the course of the next year.

Last but not least, if you look at the bullets on the right-hand side of the page, you can see that, for our end customer financing or long-term leasing for the industrial truck business, the assets and also the corresponding sale and leaseback liabilities are roughly growing in line. And that represents and characterizes the flow-through nature of that business.

So with that, let me come to the outlook for the business and turn into section four of the presentation, and I'm now on page 17. And that graph on that page explains the 2017 outlook adjustment for the order intake in the ITS segment. So if you look at the numbers, you can see that, compared with the order intake in Q3 -- in Q1 through Q3, the implied order intake for Q4, or as we have labeled it, the year-to-go outlook, based on our outlook for the entire year would have been between €1.17 billion and €1.32 billion and therefore lower than any of the previous quarters that we had seen in 2017.

And therefore, the adjusted outlook increases the upper and the lower end of the order intake guidance by €200 million each to reflect the higher-than-anticipated momentum that we've seen in this segment across the regions.

It's not on that page, but the outlook for revenue for the segment is increased similarly by €150 million at the upper and also lower end of the guidance range. And the new guidance implies a mid-single-digit growth for the order intake and revenue if you take the upper end of the guidance range. So that tells you that we're expecting the market to normalize over the coming months, especially in Western Europe and China, and it is also in line with our medium-term view that the industrial truck market will grow at a mid-single-digit growth rate.

In terms of the outlook for the adjusted EBIT, that remains unchanged due to the material cost headwinds and also the FX transaction effects. And at this point, I would like to explain this a little bit more in detail. If you look at the British pound, we had already assumed a negative transaction effect of around €20 million in our initial guidance for the entire year.

For the material cost headwinds, we're now expecting a negative impact of around €25 million for the full year, and that number obviously was not in our initial guidance. So these material cost headwinds explain the margin difference between the old and the adjusted guidance numbers for the EBIT that we have given to you.

So if you with that look at the implied margin for Q4 in 2017, it is lower than in the previous year due to these headwinds. And therefore, in terms of the distribution of the effects, I think what you can assume is that the negative transaction effect of the British pound is more or less spread equally across the quarters, whereas the material headwinds are roughly spread across the last three. And therefore, if you calculated a like-for-like margin of Q4 without these headwinds, the Q4 margin that we guide for in 2017 would exceed the Q4 margin for 2016.

And in addition, the net sales growth quarter by quarter is lower in Q4 simply because of a very strong Q4 in 2016, so a very high comparable that we're facing in the current quarter.

So with those explanations, I'd like to turn to page 18, which gives you the outlook for the SCS segment. And again, the graph on that page explains the outlook adjustment for the order intake in supply chain solutions. So compared with the order intake that we have seen in Q1 through Q3 in 2017, the implied order intake in Q4, or again, as we have labeled it here, year-to-go based on the original outlook for the year would have been between €0.9 billion and €1.2 billion and, therefore, significantly above any of the previous quarters that we have seen.

Now the adjusted outlook on the very right-hand side of the page lowers the lower and the upper ends of the order intake guidance by €450 million and €550 million, respectively, so that the year-to-go order intake is between €494 million and €694 million. And we think this is more in line with the previous quarters, and it is based on a very detailed review of the project pipeline and direct customer discussions that we had over the past couple of weeks.

So we will provide some more details on the underlying reasons on the next page. Before we come to that, let me just say that the outlook for revenue for this segment is also lowered similarly by €250 million and €400 million at the lower and upper ends of the guidance ranges, respectively. And the adjusted guidance implies a book-to-bill ratio of 1.0 times for the entire year. However, that also implies a pickup of the book-to-bill ratio in Q4.

And secondly, I would like to say that the order book for this segment provides good visibility, which is significantly more than a single quarter, so think that also gives us some good confidence with respect to the adjusted outlook.

If you look at the outlook for the adjusted EBIT, that number's lowered by €25 million and €35 million, respectively, at the lower and upper ends of the guidance ranges, due to the top line adjustment that we have made. And the implied EBIT margin for Q4 ranges from a mid to a high single-digit margin and, therefore, is below the very strong margin that we've seen in Q3. However, this is entirely due to the seasonal effects of that business that we have also seen last year. So it should not come as a surprise.

And with that, I would like to turn it back to Gordon Riske, who will talk about, as I said, the reasons for the outlook adjustments and give you some more color on this.

Gordon Riske

Yes, thank you, Thomas. I'm on page 19, highlighting the key reasons for the outlook adjustment in supply chain solutions. This analysis sheds light on the three main reasons that we have identified for the difference between our initial outlook and the adjusted outlook.

Most notably, we are seeing a hesitation to invest at our US retail customers, customers that are in the so-called verticals general merchandise and apparel. We clearly see that traditional retail players will move towards omnichannel and ecommerce fulfillment. We had anticipated to see a stronger level of activity in our US retail customers already in this year, but this has not yet been the case. Nevertheless, implementation of the strategies will automatically imply investments into the supply chain.

Secondly, we continue to see delays in project decisions by customers, which push out signing of such orders into the next quarter or year. This is not linked to a specific country or region, but holds true for projects across the US and Europe.

And thirdly, we have lost some orders among others due to repercussions from the late deliveries out of the Monterrey plant before we acquired Dematic. Those things happened in 2015 and 2016. We have taken our customers since then to Monterrey to show them that it has ramped up as planned. Throughout the year 2017, we have undertaken tremendous efforts and have already won back customers. So we believe this is a shorter-term impact.

The three levers on this page are somewhat sorted by magnitude, and the lost orders are the smaller bucket.

So let me summarize the development of supply chain solutions. We have seen double-digit revenue growth in this segment year-to-date comparing the performance with the pro forma financials for the first nine months of 2016. Also, we have set ourselves ambitious targets based on our visibility into the activities at our customers and have had to adjust our outlook, as already explained.

Nevertheless, and I think this is the most important, we are benefiting from the growth drivers such as ecommerce and megatrends such as automation and digitalization. And thanks to Dematic, our new supply chain solutions segment, we are well positioned to profit from these opportunities, and we are just as bullish and excited about the mid- and long-term business implications for the KION Group as a whole as we were one year ago.

Moving to page 20, let me present now the adjusted outlook for the full year 2017. For the KION Group, order intake for the KION Group is now expected to be between €7.55 billion and €7.9 billion. Previously, that was €7.8 billion to €8.2 billion. The target figure for consolidated revenue is in the range of €7.4 billion to €7.7 billion, previously €7.5 billion to €7.95 billion.

The target range for adjusted EBIT is between €715 million and €765 million, previously was €740 million to €800 million. This is an implied margin in the range of 9.7% to 9.9%, previously was 9.9% to 10.1%.

Free cash flow is expected to be in the range between €320 million and €380 million, previously was €370 million to €430 million. And the target figure for ROCE is in the range of 9.0% to 10%, previously was 9.5% to 10.5%.

And for the segment industrial trucks and services, order intake is expected to be between €5.65 billion and €5.8 billion, previously €5.45 billion to €5.6 billion. The target figure for revenue is in the range of €5.45 billion to €5.6 billion, previously €5.3 billion to €5.45 billion. And the target range for adjusted EBIT remains unchanged at €605 million to €630 million.

For the segment supply chain solutions, the order intake is expected to be between €1.9 billion and €2.1 billion, previously was €2.350 billion to €2.650 billion. The target figure for revenue is in the range of €1.95 billion to €2.1 billion, previously was €2.2 billion to €2.5 billion. The target range for the adjusted EBIT is between €170 million and €195 million, previously was €195 million to €230 million.

Also note that the outlook is based on the assumptions that material prices will not increase any further and that the exchange rate environment remains stable.

Now to try to put this all into context, if you look at page 21, we're showing the relative magnitude of the change in guidance for the KION Group. And that is why we justifiably use the word slight. Order intake at the upper range and lower ends of the guidance ranges is adjusted downward between 3% and 4%.

Revenue is lowered between 1% and 3%, and the adjusted EBIT is adjusted downwards between 3% and 4%.

So with that, we're concluding this report. If you look on page 22, you see our financial calendar. We will present the full year numbers 2017 and our outlook for the full year 2018 on March 1st, 2018. And with this, I'd like to conclude, as I said, the formal part of the presentation and our update call and turn it back to the operator so that we can take your questions.

Operator

Ladies and gentlemen, at this time, we'll begin the question-and-answer session. One moment for the first question, please. The first question comes from the line of Omid Vaziri of Jefferies. Please go ahead.

Omid Vaziri

Yes, good morning, gentlemen. My question was with relation to net working capital. I understand high inventory levels in the quarter have impacted cash flows. And I was wondering, does this mainly relate to the forklifts business and the growth in orders failed in that segment?

And secondly, do you expect some of this increase to unwind in the subsequent quarters? If yes, to what extent and over which quarters? If you're able to shed some more color on that, that would be very helpful and, also, other elements within the net working capital have also been responsible for this increase. Thank you.

Thomas Toepfer

Well, it's mainly driven by our supply chain solutions segment. And I think what I can tell you is we will see a normalized level by the year end. Therefore, it is an effect that is not long lasting, and all the indications that we have is we'll look at, as I said, a normal level by the end of the year.

And it comes from the supply chain solutions segment. To a smaller extent, it also came from our operating unit STILL, where we were, due to high demand, not able to ship all the units that had been ordered by the customer and also produced. So we were looking at a slightly elevated level of inventories. And we have taken measures in order to be able to ship all those units also by -- in those weeks. And therefore, also in that operating unit, we'll look at a normalized level of inventory by year end. So I think we've localized the issues. We have taken the measures. And therefore, we're confident that this relatively strong increase will go away.

Omid Vaziri

Thank you. So do I understand from that that your normalized level hopefully ahead will, as far as Dematic's impact on legacy KION's free cash flow conversion is concerned, will be a positive impact?

Thomas Toepfer

Absolutely.

Omid Vaziri

Thank you.

Operator

The next question comes from the line of Sven Weier of UBS. Please go ahead.

Sven Weier

Yes, good afternoon from my side. Three questions, please. The first one is on SCS and your analysis on page 19 for the reasons for the order delay. I was just wondering why Dematic was disproportionately impacted by the delays because, if you look at Intelligrated, for example, they had quite record order intake in Q3 and also in the first six months of the year. So I guess, if that was a more industry-wide phenomenon, why has Dematic been impacted disproportionately?

The other two questions are on the truck business in terms of the mix shift that you have. Will that situation, do you think, continue for the coming quarters that the unit growth is outpacing the value growth?

And the last question is on the rental fleet. Are you planning to expand the rental fleet as much as you did in the last 12 months for the next 12 months as well? Thank you.

Gordon Riske

Okay. On the truck mix, fact is, in some regions of the world, the warehouse, the lower-cost equipment is more than 50% and 60% of the total market. If you look to China, it's probably the fastest growing. You have a trend. I don't want to get too technical here, but again, you have a trend that the 1 million hand-pallet trucks, which are not in the statistic, are being electrified into electric hand-pallet trucks, which then do go in the statistic. So I think, from a unit count, we always have to keep that in mind. The most significant part is the warehouse segment, and it is becoming a bigger segment.

Regarding supply chain solutions, I don't know that Dematic is disproportionately. It's always a question. We have certain verticals that we are very specialized in, if I think of ecommerce and some of the, as we said in the explanation, US retailers. And other competitors may have specialties in other verticals, whether it's post and paper and so forth. So I think they are very different companies. That's the first point.

The second point is that the size of Dematic, which is almost double the size of many of the competitors, especially in North America, 10% on a small number is quite a bit different than 10% on a larger number. So I think those two things must be taken into the background.

Thomas Toepfer

And maybe just on the rental fleet, yes, I think we're facing very, very good demand from our customers in terms of the -- our rental offerings. And therefore, directionally, I would say you should expect also a rental fleet to grow at similar growth rates next year, as we see today. What I can assure you is we're monitoring very closely that we're running at a very high utilization rate of the fleet. And we're also monitoring very closely that the return on capital of that business is accretive. So we have a special eye on potentially taking used trucks and putting them in the rental fleet because that is much more capital efficient than using new equipment, despite the fact that, if you use new equipment, of course, it flatters your order intake a little bit. But what we're trying to do is to make this as efficient as possible. And we're happy with the growth rates that we currently see.

Sven Weier

And maybe two quick housekeeping follow-up questions, if I may, the first one being on the PPA line. So is it fair to assume another charge like in Q3 also for Q4? And on the net interest line, is the Q3 level something that you would also annualize, or was it especially low, or what's your guidance on that? Thank you.

Thomas Toepfer

Well, on the PPA, I think it's -- the answer is yes. You can assume a similar effect in Q4. And on the net financial expense, I'd say also the -- it is -- the number that you're seeing in Q3 is roughly representative with what we're expecting also for Q4, maybe a little bit on the low side in Q3, but again, roughly in line.

Sven Weier: Okay. That's it. Thank you.

Operator: The next question comes from the line of Jack O'Brien of Goldman Sachs. Please go ahead.

Jack O'Brien: Hi. Thank you for taking the questions. So I've got a couple on trucks and then one on the Dematic business. Firstly, you talked about a normalization in the growth environment in Western Europe. So just interested in your conversations with customers, what they are saying about replacement demand and how they're thinking, if you'd give some color there.

And just secondly, on trucks, you've made a push or are making a push into the US. Obviously, you're sort of taking some share there. But if you could give us an update on your efforts and how that's playing out in terms of market share.

And then just thirdly, on the Dematic business, I think, in the past, you've guided to 1% to 2% cost synergies expected. So that's about €20 million to €40 million. Where are we in relation to those, please? Thank you.

Thomas Toepfer: Yes, let me start with the last one. Indeed, what we've indicated, as we said, we are targeting 1% to 2% cost synergies, so 1% to 2% of the Dematic revenues as EBIT cost synergies. And we were expecting that those will materialize over the course of 2017 and '18. What I can confirm is that we're absolutely on track to achieve those. In this year, they stem mainly from some

SG&A efficiencies, from some bundling of functions in the -- in terms of insurances or in terms of our auditors, etc., etc. So I think we're getting -- we're absolutely sure to meet those numbers in 2017.

And the second half of the overall savings should come in 2018. And this is expected more from purchasing savings, where the teams are now working together and bundling the volumes, adjusting the new contracts. But as the volumes will only flow in next year, also the savings will only materialize in 2018. But overall, I can confirm the numbers. And as I said, we're expecting roughly a 50-50 split over those two years.

Gordon Riske

Yes, starting with the first one, normalization in Western Europe, I know that's a difficult term, and we discuss it often here internally because, every year, it seems we say normalization, and the actual rates are higher, sometimes significantly higher.

Our customers, all the discussions are still very enthusiastic. You see the Western Europe numbers went up again in the market for the past quarter. And we don't see any real slowdowns. But the fact is, after a number of years now, a double-digit growth or close to it, we do expect those numbers to still grow at good rates, but perhaps not as significantly or not as quickly as they have in the past quarters, although I must say those are assumptions. Customers are still very willing to invest and looking because of the change from IC-driven trucks to electric trucks, more efficient trucks, China moving from hand-pallet trucks to electric pallet trucks. So the market dynamics are still very strong.

Now North America -- I'm glad you asked that question. We're very excited about the growth that we have achieved thus far. For those of you that have been with us a couple of years, I think I said about two years ago our midterm growth used to get to 4% to 5% market share. And when I said that initially, we were just above 1%. If we can get there faster, I don't know. Every indication of the success of the product launches this year shows that we can get there faster. But before I start making a prediction and saying that we're going to get to 5% quicker, I'm just happy that the products that we have invested, the technology that we have invested has been very well received by customers, and that is fully on track.

Jack O'Brien

Okay. That's really helpful. Thank you. Just as a small side one, I know South America is a very small market for you. But I noticed, sort of relative to the market, you undergrew quite materially. Is that just a sort of mix issue, as in China, for example, or are there other factors going on there?

Gordon Riske

In -- let's see how the year pans out. Brazil is the particular case that you're talking about. Two aspects to Brazil. Brazil, right now, the market I think is about the size of the state of Hessen, maybe less, in Germany. So it's become quite a bit smaller. So one order does make a difference. And we had a fairly large project for a customer that we -- I'm proud to say we purposely did not take because it would've been a loss-making order. Whoever did take it, they decided to do that for whatever reason. But that was a particular definite decision that we decided not to take a loss-making order. That's one order, and that makes in a small market huge difference.

Jack O'Brien

Okay. Thank you.

Operator	The next question comes from the line of Denise Molina of Morningstar. Please go ahead.
Denise Molina	Hi. Thanks. I have a couple of questions on the AutoStore agreement. And I wanted to ask you about the -- well, first of all, why you decided to partner with it instead of acquiring it. I know it was recently acquired, but seems like it has pretty good EBITDA margins, around 50%. And it's growing, obviously, as fast as everyone else, kind of in the 20% level. So it seems like a product that's in demand and something that you obviously need. So that's the first question on that. And then second is just on the economics. What will be the margin on that business relative to your margin at Dematic at the moment?
Gordon Riske	Sorry, could you repeat the second part of the question?
Denise Molina	Yes, I'm just wondering what the economics will be, like what the net result will be in terms of the margin that you get on that, on those sales relative to the margin that you get at --
Gordon Riske	On AutoStore?
Denise Molina	Yes.
Gordon Riske	First of all, why didn't we buy it? There were a lot of activities at that time. We had some other things to do at that time. And the price, the multiples were extremely high to us, not really justifiable. But AutoStore is a great company. We picked them, and I would say it goes both ways. AutoStore has also relations

with others. We have a small company that we acquired a couple of years ago, Egemin. There was a local sales agreement with AutoStore for certain countries. I think some of our competitors also have some local agreements for certain markets in certain countries. And the agreement AutoStore and Dematic is much broader. It's a global because Dematic is really perhaps the only one that's a global footprint the way we have it. So that's the reason the match works very well.

Denise Molina Okay. Is that -- sorry, go ahead.

Thomas Toepfer In terms of margin, you just have to keep in mind AutoStore is always part of a bigger project that we deliver to the customer. So it's one, I would say, component in an overall solution that we provide. And that component fits very well with the other items that we can deliver.

In terms of margin, I think we wouldn't disclose any specifics. But I can tell you it is -- it will generate the same margins that we generate with other projects of that size. So it is not specifically accretive or dilutive to the overall business.

Denise Molina Great. Thanks. Can I just ask a couple -- just two quick follow ups on that? Did -- is the agreement exclusive in any regions? And also, why do you need the AutoStore product when you have things like multi-shuttle? What is -- where is the demand coming from that you're not meeting with your current product?

Gordon Riske Yes, no, it's nonexclusive for both sides, so mutually not exclusive. So it requires both partners to work trustfully with each other. And this AutoStore solution for particular applications is more dense.

Denise Molina	Yes. Okay. Are you eventually going to replicate that product in your own product line, because it seems like it's in demand, and you obviously need it? It's not exclusive.
Gordon Riske	Well, we certainly wouldn't divulge our midterm R&D plan in any call at this point. And right now, we're happy that we made the agreement. And we will make that a success.
Denise Molina	Okay. Great. Thanks so much.
Operator	The next question comes from the line of Felicitas von Bismarck of Deutsche Bank. Please go ahead.
Felicitas von Bismarck	Yes, thank you very much. A couple of more questions, please. First of all, since last week, were you able to quantify how much of the order shortfall was actually coming from the hesitance to invest and how much from the project delays? And the second question would be, could you comment on what happened in the North American market, because even if I take out the other numbers, it still looks like it's slowing quite a bit? And the third one is, if you were assuming the industrial trucks business to slow in Q4 and likely also in 2018 because you are dealing with base effects, right? So if you assume this to slow, do you expect a larger tailwind from new businesses growing slower versus services, or do you expect this to be eaten up by unit orders outgrowing value orders? Thank you.
Thomas Toepfer	Felicitas, can you repeat the last question? I didn't fully follow your line of argument. So please repeat that.

Felicitas von Bismarck: Yes, sure. So when you expect to grow slower next year, I assume it would be on the new business in industrial trucks. So I would say that the difference between the growth rates in new business and aftersales is coming -- is becoming slower and is becoming smaller, so to say, and the margin difference is so big. So I would assume you are expecting a tailwind from --

Thomas Toepfer: In terms of margin. Okay. Now I get your question. So yes, in fact, you're right that the -- we were expecting a normalization in the growth, but this will also have to some extent an effect on the services business because please remember also rental solutions are in that business. So I would say the difference in growth will not be so significant, so that I would not expect specifically a margin effect on group level that will stem from that business. At least, it's not -- I'm looking at my controller here. It's not in the factor list that we have for the 2018 plan.

Gordon Riske: Okay. And North America, first of all, let's just take the baseline again. So this year, we -- the market 4.6%. Last year, full year was 2.7%. So first of all, it's growing.

Secondly, the momentum on electric trucks and IC trucks is also strong. We do have a base effect. That is, the slowdown in Q3 is driven by a high level of Class 3 warehouse. That is, September 2016 was the strongest month in the entire year 2016 for these products. And Class 3 warehouse, a lot of those go into distribution centers. So that's really a timing question. That could turn around again in the fourth quarter if a couple of orders are taken or made by customers. Bottom line is, though, that the North American market, we see what our customers say and what our order book says is in great condition.

Felicitas von Bismarck	The question on the quantification.
Gordon Riske	Yes, the quantification, we said we have the three buckets. They stayed the same from last week. We were still three buckets. We said the loss to order part is the smaller but an exact quantification that's -- we, of course, know our numbers, but that's not something we would put into the call. Fact is we made an adjustment. We're very confident about our basis. And things will be fine. But that's no new logic today than last week.
Felicitas von Bismarck	Okay. Can I follow up? If you can give us like a growth indication of organic sales for Dematic, right, of double-digit growth for the solutions business in its entirety, can you also give us an organic -- like an indication of organic orders for the nine months?
Thomas Toepfer	Yes, I think we said that repeatedly. While the growth rate for the revenue is double digit, the growth rate for the order intake is slightly lagging behind that number. So I think that should give you good guidance that the business is performing in line with the expectations that we had set previously, which is double-digit growth.
Felicitas von Bismarck	Okay. Thank you.
Operator	The next question comes from the line of Peter Murdoch of Morgan Stanley. Please go ahead.
Peter Murdoch	Yes, hi, Thomas. Hi, Gordon. Two questions, if I may. Thomas, you talked about -- in SCS, you talked about two benefits to the margin. One was the ramp up in Monterrey, and the other was

project mix on margins. Could you just go into that a little bit, explain what that impact is?

And then I just wanted to go onto SCS. So the midpoint of your guidance is €2 billion here of orders for the full year. When I look into revenues next year, what is to -- I would assume your revenues would be the €2 billion of orders. What is the delta to that number, as in what is -- what can change next year that would make that number go up, as in how do the orders feed to the P&L, if you see what I mean?

Thomas Toepfer

What we just wanted to say is that we were negatively impacted last year and also actually in November/December, so the first numbers of 2016 that you've seen, by Monterrey because we had significant delivery issues on the one side. And that, of course, made some customers unhappy with now -- as Gordon said, had some negative repercussions also on the order behavior on the customers.

But also, it created significant cost in 2016 to deliver at all because we had significant cost for expedited freight, for additional workforce at the installation site, etc., etc. And we said at the beginning of this year it's not a strategic issue; it's an operational problem. And we can solve that. And that's what we did. We sent our team to the Monterrey factory. And I think we can say now that the factory's up and running, so that simply many of those frictions and also of those costs that we incur did vanish. And that obviously has a positive effect on the margin. And that's also what you see -- what you have seen in Q2, but what you've then also in Q3, which was the factor for that I think very satisfactory margin that we realized in those two quarters.

And then the project mix simply means that I think we've been very active in chasing profitable projects, especially -- and I think it's no secret that the North American activities have been slightly more profitable for Dematic than the European activities. So what we're doing is taking some of that knowledge and bringing it to -- also to Western Europe in order to chase for profitable projects. And that's simply also had a positive impact in the numbers that we've published. So those are the two factors.

Then I think on the -- your question on 2018 and growth, I'm not exactly sure whether I got your question completely right. We haven't published any guidance for 2018. That's the first thing. But what we have said is that we're expecting the business to grow faster than the market. And the market, we're expecting a 10% growth. So the question usually behind that is, what does have to happen in Q4 in terms of order intake to lay the basis for that? And I think, if you look at the guidance, you can see that there will be a significant uptick in the book-to-bill ratio in Q4 if you take the midpoint of the guidance that we've given. So that is one important factor.

And the other important factor is don't forget there's a lot of what we call win-and-do business during the year. So a significant chunk of the business is won in terms of order intake and then realized as revenue in that respective year.

And thirdly, as you know that 25% of the business is services, where obviously the order intake and the revenue always falls into the same quarter. So I think the message is only, from what we can see today, there's no indication that would let us believe that we cannot achieve our guidance numbers for the growth rate for the business that we have given.

Peter Murdoch

Okay. Very clear, Thomas. Just two quick follow ups. On Egemin and Retrotech, we can get the -- you can see the numbers from last year of what orders were doing for those businesses combined. How do they compare nine months '17 versus nine months '16 order intake?

And then just on large orders for Dematic, you've talked about that before. If you -- and I think a large order, Gordon, you said before, can go up to €100 million. If you had one of those, do you announce it? Do you put a press release out? How do we know when one comes in one quarter to the next?

Thomas Toepfer

Well, on the first question, Egemin and Retrotech, the fact is we don't publish those numbers. But even if we wanted to, we couldn't because those businesses have been fully integrated into the Dematic operations. So there is no -- even in our internal numbers, no separate order intake for those two businesses. I think that's a fair answer. We don't have those numbers.

And secondly, on big projects, we usually don't announce those things also because our customers sometimes don't want it. And therefore, it's simply a question of contracts that we have and also in terms of respect for the customers.

Peter Murdoch

Okay. Perfect. All right. Thank you, Thomas.

Operator: In the interest of time, please limit yourself to two questions only. And the next question comes from the line of Markus Almerud. Please go ahead.

Markus Almerud: Hi, Markus Almerud from Kepler Cheuvreux. Two questions then. Can we just talk a little bit about seasonality in supply chain solutions, so both in orders as in sales? So we know that Q4 is the weakest in terms of sales, but we also saw, well, an increase in orders and a quite sharp decrease in sales. So is there a seasonal pattern that explains that, or was there anything else? That would be helpful. That's my first question.

Thomas Toepfer: Well, on that one, there is -- I think you have to differentiate between lumpiness and seasonality, first of all. So to the order intake, there is no specific seasonality, but there is, of course, some lumpiness. And as you know, there are some projects that can be as big as €100 million. And therefore, what may look as seasonality at first sight is simply shifting of orders from one quarter to the next, but there is underlying no specific effect that is tied to the season.

And that's different for our revenue, which has a seasonality in the SCS segment, specifically in Q4, because many of our customers don't want us to be around in their warehouse during the Christmas season to do installations. And if you don't installation according to the percentage of completion method, you don't book revenues. And that is the fact that you observe in that case. So I think this is how I would describe it, and I hope that's an answer to your question.

Markus Almerud: Well, between Q2 and Q3, so you saw almost €600 million of revenues in Q2 falling down to €514 million in Q3. So that's quite a sharp drop. And was there -- again, was there a completion of -- percentage of completion which was behind that, or there's no seasonality behind that, between Q2 and Q3?

Thomas Toepfer — No, there's no specific seasonality behind that.

Markus Almerud — Okay. Then my second question is regarding the end market split in supply chain solutions. So in the investor presentation, you have on page nine, which you were referring to last Thursday, where you have 13% ecommerce and then general merchandise and apparel is 26% and 8%, respectively. But this is from fiscal year ending 2015, and I would assume that this has changed. How much is ecommerce right now? And then the parts which you say are suffering, general merchandise and apparel, how much are those or the business mix right now? I know it's difficult to say because it's lumpiness, again. But roughly, how has this changed, and especially the ecommerce part?

Thomas Toepfer — Well, again, it's a little difficult to quantify, but what I can tell as a -- I would say, as a direction, is that the bucket of ecommerce has increased because, not surprisingly, it's the strongest growth segment in the industry. And therefore, also for us as a customer base, that bucket has probably increased. And if we were to do the same set of numbers again for 2016, you would see a larger chunk of the pie.

Markus Almerud — And can you say anything about -- if you look over time and the underlying assumptions behind the 10% growth in the market of all the various automation basis, the ecommerce part of that is growing by how much over time roughly?

Thomas Toepfer — Hard to give you an exact number. I think, if we look at the studies that we see, and they differentiate -- kind of differ by quite a bit, I would say it's in the range of 15% to 20%. But again, there's a vast variety of numbers and studies out there. So I would struggle to give you a very precise number.

Markus Almerud — Yes, but this ballpark is reasonable to you as well, as well as you know the business. Okay. Thank you very much.

Thomas Toepfer — Thank you.

Operator — The next question comes from the line of Frederik Bitter of Exane BNP Paribas. Please go ahead.

Frederik Bitter — Yes, hi, good afternoon. Thanks for taking my question. It would only be one, having asked questions last week already. So it would relate to both divisions actually. And I was wondering, after just about a year now of Dematic integration, how do you think today about cross-selling potential opportunities?

Gordon Riske — Just as enthusiastic as when we bought the company, but we always said initially our synergy topics would be in the first phase on the cost, the 1% to 2%, the other coming later because we do need some time for the organizations to work together. I can say that's also a different speed, depending on where they are in the world. Brazil is fully integrated. So there's one organization that sells everything, although it's a small organization. In Asia, we have -- are working on projects together. Here in Europe, we have also some particular customers where we're working together, but we're enthusiastic about that. I can't quantify that, what the exact effect is going to be in '18, but that is a little longer-term thing. But it does -- already showing positive effects in the first year.

Frederik Bitter — So you would expect some positive impact from '18 and probably over time when the teams work together.

Gordon Riske — Absolutely. Simply, the better knowledge of customers and the information on which projects are coming down the line is already a benefit in its own.

Frederik Bitter — Yes, okay. Great. Thank you.

Operator — I hand back to Mr. Gordon Riske for closing remarks. Please go ahead, sir.

Gordon Riske — Yes, thank you, all, very much for participating in this call for the numbers, final numbers Q3 2017. And we look forward then in 2018, 1st of March, for the upcoming call. Yes, financial press release will be the 1st of March, and then the quarterly statement will be on the 26th of April. So we will hear from each other again at the beginning of next year.