KION GROUP AG

Q2 2018 Update Call

Conference Call Transcript

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Anke Groth (CFO)

Gordon Riske

Thank you, and welcome to our update call for the second quarter of 2018. Presenting with me on today's telephone conference for the first time is our CFO Anke Groth, who joined KION in June of this year. As a basis for the call, we'd like to use our Q2 2018 presentation. It is available on kiongroup.com under Investor Relations in the Presentations section.

We will be presenting as always in four parts during today's call, and we will then open it up for discussion with your questions. I will begin with the strategic and financial highlights of the second quarter 2018, followed up by a market update. Anke Groth will then provide you with the financial update, and we will close the call with the confirmation of our outlook for the full year 2018.

So turning to Page 3, we have summarised our strategic highlights for Q2 2018. With our annual results, we published our updated strategy KION 2027. It sets the course for further profitable growth over the next decade, based on the strategic fields of action, energy, digital, automation, innovation, and performance.

Along these fields of actions, we have continued to implement initiatives during the second quarter of this year. And our brands have continued to launch highly innovative new products and service solutions, for example, STILL's award-winning compact, energy-efficient RX20 electric forklift family, with load capacities from 1.4 to 2 tons; Dematic's versatile robotic piece-picking module that delivers pick rates of up to 1,200 items per hour, ensuring on-time delivery of a wide variety of SKUs; and Linde's new flexible rental concept for lithium-ion batteries, no matter where the customers lease or rent the equipment.

At tradeshows and customer events throughout the second quarter, KION presented itself as a holistic solutions provider. At Linde's biannual customer event, the World of Material Handling show in June, for example, Linde and Dematic jointly showcased combined automated solutions for forklift customers.

And finally, with the announcement of the new Chief Digital Officer position, we have underlined our focus on digital business transformation. Susanna Schneeberger will join us in October of this year, and she will drive our key strategic initiatives in the field of mobile automation, robotics, and new digital solutions, into which we have already invested further since the announcement of our long-term KION 2027 strategy. We want to continue offering our customers the right solutions in our industry.

Turning to the next page, before I summarise our financial highlights for Q2 2018, let me just add a technical note. Throughout this presentation, key figures for 2017 have been restated due to the initial application of IFRS 15 and IFRS 16. You can see the full comparison on one page, Page 19 of this presentation.

So moving back to the highlights, we continued our positive trend with a boost in SCS orders. Despite significant headwinds, this allows us to confirm our outlook for the full year 2018. Regarding top line, order intake for the KION Group grew very strongly by 23% to €2.4 billion, and revenue grew by 1.5% to €2 billion in Q2 2018.

The Industrial Trucks and Services segment, short ITS, increased its order intake by 2.2% to €1.5 billion, and its revenue increased by 3.7% to €1.4 billion. Supply Chain Solutions segment, SCS, with its project business, showed a boost in orders in the quarter despite significant FX headwinds, generated order intake of €874 million at 93.3%, almost double the amount of the previous year. Revenue grew by 3% at a constant currency, but declined in euro terms to €579 million, 3.5% below previous year.

On profitability, the KION Group's adjusted EBIT margin declined to 9.2% compared to 10.5% last year, totaling to €187 million for the second quarter 2018. The ITS segment saw significant production inefficiencies from delivery bottlenecks and delays at selected suppliers, as well as headwinds from material cost and labor cost. The margin therefore decreased to 10.2%.

The SCS segment margin was impacted mainly by underutilization of its project-related capacities, personnel capacities due to weaker order intake in the previous quarters. It therefore declined to 8.9%.

Compared to the yearend 2017, net financial debt increased slightly to €2.3 billion compared to €2.1 billion at the yearend due to working capital issues, which are also related, of course, to the output. Impacted mainly by increase in working capital, free cash flow was €9 million for the first half of the year 2018.

Let's move onto the market update on Page 6, focusing on industrial trucks, and shows the global market development by region. Overall, the global market remained on its growth path with momentum actually accelerating in Q2 2018. After a somewhat slower first quarter, Western Europe showed a very strong growth of 19%, in particular small warehouse equipment, or as we call it, Class 3 entry-level equipment. Eastern Europe grew even by 28%, again displaying high growth in most key markets. China, with a very strong growth of 30% in Q2, driven in particular by demand for electric trucks and Class 3 warehouse equipment. North America, with 8% growth in Q2 compared to a strong Q2 2017. South and Central America also grew by 8% in the second quarter. As a result of the regional developments, the global market grew at 19% in the second quarter of 2018.

Now if we compare this with KION's growth on Page 7 in the industrial trucks by region, again measured in units order intake, Western Europe, KION saw a strong growth of 10% in the second quarter, maintaining a very solid momentum for the first half of the year, albeit slightly below the market. Eastern Europe, KION grew slightly ahead of the market with 29%, based on a strong position in Poland, Russia, and other key markets. In China, we grew as well in electric and warehouse equipment. And we thereby remain well positioned to benefit from the shift towards electrically driven trucks.

In North America, the Q2 2017 also included a one-time positive effect. So last year, we had a positive order intake effect due to new product introductions at the ProMat Trade Fair in April, which does impact, of course, the growth rates in this year. South and Central America, KION saw a 13% increase, supported by continued recovery in Brazil. Overall, KION saw a good Q2 with global unit growth of order intake of 8.4%, benefiting from a very strong global market. We recognised a total order intake of 57,000 units in Q2.

Let me also briefly comment on the development in the market for Supply Chain Solutions. As you know, there are no comparable market statistics for Supply Chain Solutions. We have therefore not added a market update. But continued customer demand and our strong order intake in Q2 clearly support that the market for automation systems sustains its growth momentum and that underlying growth drivers and the trends for those remain intact. Dematic, as the global leading player in this field, is best positioned to capture this growth and has impressively demonstrated its strong competitiveness with a record order intake in this quarter.

And with that, I would like to turn it over to our CFO Anke, who will present the financial update.

Anke Groth

Thank you, Gordon. And also, a very warm welcome from my side. I am looking very much forward to meeting you all in person very soon with the conference season beginning in September. For now, let me start with Q2 financials.

Turning to Page 9, you will see the key financials for the second quarter 2018. Order intake grew strongly by 23% to around €2.4 billion, supported by a boost in SCS orders, while at the same time impacted by a significant negative FX translation effect of €86 million. The order book at the end of the quarter stood at €3.1 billion and thus strongly above yearend.

Revenue grew by 1.5% to around €2 billion, also impacted by a significant negative FX translation effect of minus €68 million. Adjusted EBIT declined to €187 million, which represents a margin of 9.2% below Q2 2017. It was impacted by negative FX translation effects of minus €7 million and additionally by headwinds from delivery delays at selected suppliers, material costs, and labor costs.

Net income was €79 million, was also significantly below the previous year, impacted by operating performance and also higher net financial expenses. Overall, we saw a boost in quarterly SCS orders, once again reflecting the project nature of the business, while at the same time significant headwinds impacted our operations.

Turning to Page 10, you will see the key financials for the first half of 2018. Order intake grew strongly by 11.9% to €4.3 billion. Revenue growing by 1.9% to around €3.9 billion. Adjusted EBIT declined to €345 million, which represents a margin of 8.9% and thus below the first half of 2017, again due to negative FX translation effects, as well as headwinds from supplier bottlenecks, material costs, and labor costs.

Net income was €148 million, is at around prior year level. The lower operating performance was compensated by lower PPA and nonrecurring items. Overall, growth and margin were impacted by headwinds.

Let me continue with the key financials for the ITS segment, and I will comment on the second quarter 2018. We are now on Page 11. Order intake grew by 2.2% to €1.5 billion in this second quarter 2018, impacted by a €29 million negative FX translation effect. Revenue grew by 3.7% to €1.5 billion, also impacted by a €29 million negative FX translation effect.

In the revenue line, new business grew at 0.2% and our services at 7.3% in that quarter. Adjusted EBIT declined by minus 7% to €148 million. This equals a margin of 10.2% and thus below a margin of 11.4% in Q2 2017.

So we saw delivery issues and delays at selected suppliers, which led to production inefficiencies at our factories, with the main impact being in Europe. What do we mean with inefficiencies? We already reported significantly higher inventories at the end of the first quarter. This related to trucks that could not be shipped out of the factory due to missing parts. As soon as the parts come in, we have to rework the trucks and fit the parts after the truck has already come off the production line. This means that we have to touch the truck several times, which requires additional shifts in our assembly operations.

We have defined countermeasures for these delivery issues and should see those levers coming effective in the second half of the year. We therefore expect a catch-up effect in factory output towards yearend.

In addition to the described supplier bottlenecks, we saw continued headwinds for material costs as well as labor costs, including among other the new German tariff agreement as of April 2018. Overall, we saw headwinds weigh on segment margin, but please also do keep in mind that Q2 2017 was a very strong prior year quarter. So there are higher comps for Q2 2018.

Let me come to the Supply Chain Solutions segment. We are now on Page 12. And I comment on the second quarter 2018. The segment saw a boost in orders, with order intake of €874 million, almost double the orders received in Q2 2017. This confirms that the underlying drivers and trends in the market remain fully intact. It confirms Dematic's leading position in the field of automation systems. Note that in the order intake as reported was again a significant €57 million negative FX translation effect. Otherwise, the boost would have even been stronger.

Revenue declined by minus 3.5% to €579 million, impacted significantly by negative FX translation effects of minus €39 million, as well as by a weaker order intake in the previous quarters. Normalised for the substantial currency impact, the underlying business in local currency would have seen revenue growth of plus 3%.

Adjusted EBIT was at €52 million in Q2 2018, thus resulting on a lower adjusted EBIT margin of 8.9% compared to the 10.7% in the previous year. Adjusted EBIT saw significant negative FX translation effects, minus €6 million, and profitability was impacted mainly by underutilization in Dematic's project-related capacity, due to the weaker order intake in the previous quarters. Overall, the boost in SCS orders clearly confirms Dematic's leading position.

Page 13 shows the reconciliation from the adjusted EBITDA to the net income for the group. Let me highlight selected items. First, EBIT was impacted by headwinds. Non-recurring items are down by €12 million, standing at €3 million. Last year was strongly impacted by Dematic by SCS. PPA relates to Dematic as well and comes down. The increase in net financial expenses is based on a positive FX impact in the first half 2017 from a US dollar intercompany loan related to Dematic. This effect is lower in the first half of 2018, and due to ongoing restructuring of the legacy legal structure, this effect will not occur in 2019. The effect is, by the way, non-cash effective and a pure translation effect.

Taxes are slightly higher based on higher income. So the tax rate, the tax quote is 31%. Therefore, net income is at €148 million and earnings per share at €1.26.

Details on the free cash flow are shown on Page 14. I will start with the last line on this page and with a lower level of free cash flow to the firm of €9 million for the first half of 2018. This was mainly driven by changes in net working capital from increased inventories due to the already mentioned delivery delays at selected ITS suppliers. We saw higher tax prepayments due to higher results. And our rental Capex was driven by business volume. This means operating cash flow is significantly lower, and with higher operating Capex, free cash flow is coming down.

Page 15 shows the net debt of our business. Net financial debt of €2.3 billion as of June 2018 is slightly above the €2.1 billion as at yearend. Net financial leverage of 1.5x is almost unchanged to December 2017. The initial application of IFRS 15 and IFRS 16 calls for an adjusted definition of industrial net operating debt, our so-called INOD. The main changes relate to the presentation of procurement leases and the presentation of liabilities from long-term leasing. Based on the adjusted definition, industrial net operating debt increases to €3.2 billion compared to a €3 billion as at yearend. So you see the increase in leverage here as well. The respective leverage at the end of June 2018 of 2.7x is above the level of 2.5x as of December 2017.

And with this, I hand back to Gordon for the presentation of the outlook.

Gordon Riske

Yes, thank you. Based on page 17 here, yes. Based on the presented figures for the second quarter of 2018 and despite delivery issues at selected suppliers, we do confirm our outlook for the full year 2018. The outlook is based on assumptions around FX rates, material and labor costs at the time when we defined our guidance. And the outlook, of course, assumes that our countermeasures to resolve our supply chain issues in the ITS segment prove effective.

Actual business performance may deviate from the outlook. This depends particularly on macroeconomic and industry-specific conditions and may be negatively affected by increasing uncertainty or worsening of the economic and political situation. The latest tariff increases between China and the US will have an effect on our EBIT in the second half of this year. But most likely, looking isolated at the tariff itself and based on a first internal assessment, we are talking about a low single-digit number. And of course, any threat or the threat of additional tariffs brings along additional uncertainty for the development of our global activities. So, I do believe yesterday's US and EU agreement was a very positive signal as far as that is concerned.

So in summary, for you, the main points I believe is we have a very strong market. It was very strong in Q2. SCS has an absolute record. We are very happy with the record in Q2, very strong business performance. ITS, we have lots of forklifts to build into Q2, and we have a great plan to make sure that those do get built in time for our customers. That is the main point.

Now looking onto Page 18 , you will see our financial calendar. The next event is the presentations of our Q3 2018 financials on October 25th, 2018. In the meantime, after the summer break, we will be presenting at several conferences and roadshows. And we are looking forward to continuing our personal dialogue with you at these occasions.

And with this, we would like to close our formal part of this update call and turn it back to the operator so that we can take your questions.

Operator — Ladies and gentlemen, at this time, we will begin the question and answer session. One moment for the first question please.

Philippe Lorrain — Good afternoon, everybody. It's Philippe Lorrain here from Berenberg. Quick questions on the market. You mentioned that strong performance in Q2, also a strong performance basically in the first half year. So where do you see these volumes trending perhaps by region for the remainder of the year or for the full year as a whole? And do you expect that to basically translate as well into very good numbers of yours, or do you have special mix effect that perhaps will lead to a different outcome? That would be the first question.

Gordon Riske — Okay. Yes, it has been an outstanding Q2, and I am a little bit surprised at all the effects we see around the world with all the questions that our market is still performing. So basically, with the market that we see ahead of us, we will be able to confirm our guidance. That is why we are able to confirm our guidance. The mix effect is also within the numbers that we have in our guidance. We have seen especially in Europe -- that is perhaps a little bit unusual -- a very, very strong growth in, let's say, low-value -- high-volume, low-value Class 3 warehouse trucks.

Philippe Lorrain — Okay. Great. But can you make a statement where you see perhaps growth coming in at global level for this year? You used to communicate that, basically, for the next couple of years, you expect a mid-single-digit performance. Should we expect a big downturn, let's say, towards the yearend because we have got a basis effect somewhere, or is there like more solid performance?

Gordon Riske

Philippe, I have looked at that. I have been saying it every year, and I looked at our numbers. We have grown 40% in the last four years, so double digit. And if I look at the market in the last four years globally, it has grown about 35%. So we have actually outgrown the market. We have -- in our plans going forward, we do see some normalization in 2019, 3%, 4%. But this industry, material handling, is a very solid growth this year. And as I say, if this US-EU thing gets worked out a little bit and China and US get back on track, we will have again a very solid full year, and we do not see really any slowing down in that terms of 2019, but kind of a little bit more normalised growth. That is what we are projecting.

Philippe Lorrain

Okay. Great. And then I have got one question basically on these bottleneck issues that you have. Perhaps you could quantify for everybody here the effects of these bottlenecks basically on the margin in the truck business in Q2 perhaps and as well give us some color on whatever the trend has been recently on these bottleneck issues. I guess that part of the two fields in Q2 was related to Deutz. Perhaps you can confirm.

Anke Groth

Hi, Philippe. Let me comment on that one. Yes, as you said, we have delivery delays at selected suppliers. If I want to quantify that, I would say it is a high single-digit million euro amount. And the effect will stay with us throughout Q3, and also it will also touch Q4. As you know, Q4 is normally a strong quarter. So yes, the effect will stay with us, and you will see it until Q3 definitely and Q4 as well. But we are also getting the trucks out. So as Gordon has mentioned, you will see also profit coming in.

Gordon Riske	That particular question, Deutz, you know that is the strike at Halberg Guss. That has to do with Volkswagen, all these other things. It is nice to see that they have agreed with the IG-Metall this weekend to go to a mediator. And we are in every-day, every-hour contact with them. We do see our engine deliveries if this gets through because, during this mediation time, they will produce. So we should be able to get back on track here in the third quarter.
Philippe Lorrain	Okay. So is it fair to assume that, if there is a normalisation of this bottleneck issue in the next couple of quarters, your top line might accelerate, and the effect from the operating leverage should kick in quite nicely, while at the same time, you basically do not see, let's say, more or less incremental cost coming from these inefficiencies that you had in the production?
Gordon Riske	Well, as Anke just said, we have some incremental costs. She listed them. And our main point is, even with all those issues that are facing us, we do have confidence to meet our guidance, and that is why we are saying that today.
Felicitas von Bismarck	Yes, thank you so much. I have another question. You seemed to stress just now that the guidance is attached to the assumptions of no change in material cost and raw materials and stable exchange rate. I do not recall you doing that every time. Is that more of a problem right now? So because we are actually lagging material cost, exchange rates, and so forth, is the actual guidance already lower? That was the first question.
Anke Groth	Hi, Felicitas. Yes, happy to pick up your question. Yes, we are mentioning it. I think we also mentioned it during Q1. But I look

over to Karoline, as I was not here at that point in time. Yes, we are facing the headwinds. And if you take what we have commented into consideration and you look at our guidance range, we confirm our guidance. But you might could assume that, with all the headwinds we are mentioning, we would not come up at the upper end of the guidance. That is how much I can say to that one.

Felicitas von Bismarck: Okay. If I take out the high single-digit amount that you were just mentioning, we are still lagging quite a bit in Q2. So that is basically due to higher raw material costs, higher exchange rate, higher personnel, and these kind of things, or how would you classify that?

Anke Groth: Yes, as we have explained, you are absolutely right.

Felicitas von Bismarck: Okay. And then the other question, can you comment a little bit in more detail what is happening on the profitability of the SCS business, so apart from the supply chain business -- sorry, the supply chain business.

Anke Groth: Yes, absolutely. We have commented on that one. It is the really underutilization of capacity. That is mainly engineering personnel we are talking about. You know that we have been quite weak in order intake in the first quarter, and also the backlog yearend was not so high. So that means that our engineering capacities are underutilized. Engineering personnel is very important for our business for really implementing, conducting our projects properly. So that is not a flexible cost item. Let me phrase it like this. So the cost of staying with us, but we cannot bill it to our customers because the projects are not there. So that is what we mean with underutilization.

Sven Weier

Yes, good afternoon. First one is actually just another follow-up question on the definition of the guidance because I am still a bit puzzled here because, on the one hand, I understand you that the guidance was given before all those unexpected issues came up, but if I understood you correctly right now, you basically confirmed those absolute numbers because you are confident that you will be making up for those unexpected headwinds in the second half. Is that the right way to look at it?

Anke Groth

Not entirely. So we are mentioning headwinds, like for example, the labor costs. The labor costs were already part of our guidance. There are headwinds, like the material costs, which have not been seen so strongly at the beginning of the year, but we are also working on countermeasures. So I would really differentiate here, but I think the most important point is that we are confirming our guidance. Despite all those headwinds, we still stick to our guidance. And I repeated it might not lead to the fact that we are at the upper end of our guidance what these headwinds are causing.

Sven Weier

So we basically do not have to look at the guidance saying that 770, like the low end of the guidance was before the currency impact and before the unexpected issues, and those would need to be deducted, but you basically compensate for that and will still come out, as you said, towards the low end.

Anke Groth

We also, of course, partly compensate, Sven. And apart from that, we give a range as a guidance. And that is for good reason. Otherwise, we would give you one point and then say, "Okay. Look, deviations in material or whatsoever are causing a different number." But it is a range for very good reasons. And I think I am closing my comments now with respect to this point. Hope that is okay, Sven. Otherwise, pick it up with Karoline, please, offline.

Sven Weier

And the other question I had was on the Supply Chain Solutions order intake. Could you just give us a little bit more color in terms of, was it several orders from one client or various clients? And to what extent are you done now on catching up on the delayed orders from last year?

Gordon Riske

Well, as we said in the last quarter, we had a number of orders that we had the first part, the long-lead items so-called. And so those dropped through in the second quarter as we expected because we had good visibility. But I must say the second quarter kind of hit on all cylinders, and very strong North America, which was exceeding our expectations, but also, Europe did a great job, and we even had a little bit in China. But it was really across the board. There was not a particular customer or region other than I would say North America was certainly the strongest.

Sven Weier

And the pipeline for the next couple of quarters here still as active or, as you said, a bit unusually high in Q2, obviously?

Gordon Riske

Yes, we are confirming guidance. We have a good pipeline and a good visibility so that we are able to confirm our guidance.

Sven Weier

Okay.

Sebastian Growe

Yes, good afternoon, everybody. Three questions from my side, the first one on ITS, if I may come back to the headwinds that you have seen. My question is if these are really recoupable because, as things stand, I guess you have to touch the trucks twice, as you said it in your prepared remarks. So I just struggle to really understand how you can really recoup that one. And then you I think also referred to some countermeasures. Can you just shed some more light on what these measures are about? And then I would have one more on SCS and on cost inflation and more general. Thank you.

Anke Groth

So I comment on the recouping. Hi from my side. As we said, of course, some of the cost inefficiencies will stay with us. We have to touch the truck several times and so on. And we still have to do that. Parts are coming in, and then the truck is reworked. But once a truck is reworked and we deliver the truck to the customer, and the profit is coming in. But some of the cost inefficiencies will stay with us. But we can sell the trucks and deliver the trucks to the customer. Gordon?

Gordon Riske

Yes, let me talk about the countermeasures. First of all, again, a general statement, I am very happy that we have such a booming market. I am very happy that all of our factories are more than full. As I said, 40% in four years, that is a lot to handle for our supply chain and for our own factories. So that is a general statement. We are actually in a very good position in a solid market.

Second point is the countermeasures, that is kind of our daily business in terms of purchasing, supplier development teams shifting to productions. We -- for Monterrey, the things we did last year getting it back up to speed, our new ramp up, and thank God we did it for all the orders now for SCS coming in with our expansion capacity in the Czech Republic. But our countermeasures, I would say it is really some of the basic things that we are doing, from containing our suppliers. We have an entire task force with internal and external people at all of the key critical suppliers. That was kind of the beginning of this situation first quarter. We are kind of in Phase 3 now, what we call it. Our backlog reduction program to make sure we have enough parts coming in, and then kind of our restructuring, the last phase is making sure that, for 2019, we have things in place.

We have taken in our big factories in Hamburg for part of it and in Châtellerault, in France, moving into a second -- sorry, third shift, so third-shift assembly, which is quite unusual in this business, to make sure we get the stuff out. So we have quite a wide range of programs, very professional teams working on this around the clock. We also have good cooperation with our unions, I must say, with working special shifts. So I think we have everything in place to handle this outstanding order backlog.

Sebastian Growe

That is very helpful. Thank you for that one. And if I may take you up on this one that the factories are very full, the market is booming, obviously, there is some part of the cost structure which is I think also going up then in 2019. You have the agreement with the unions, especially for the German workers, which is up another 4% or so. What am I getting wrong? So is there really upside to the margin if you see, obviously, that you are getting also to some limits eventually in the production flows? I do not want to criticize. It is just really an open question. And are we seeing simply some limits due to the state of the cycle where we are?

Anke Groth

I think this year is really an extraordinary situation with the missing parts from the suppliers. That really causes inefficiencies in our factories. We do not see that effect, if nothing happens again in 2019 on the supplier side, to come again, Sebastian.

Sebastian Growe — Okay. Fine. And the last one then on SCS, if I just may, on the pipeline and then also on the mix that Sven asked before. You have not really touched upon the point I think how much eventually the share coming from elephants versus rabbits, as you call them, so small versus large projects. And the other part of the question, remind us on the verticals if you can just shed some more light on really what is coming from e-commerce on the one side, and are there any, say, super-booming verticals whereas others are eventually still struggling as we saw that in 2016 with apparel, for example, or general merchandise, it would be quite helpful. Thank you.

Gordon Riske — Yes, in the -- we don't -- to report mix on a regular quarterly basis is a little bit difficult. We had the Capital Markets Day, where we showed large orders 38% or so, medium about 20%, and then the rest smaller orders. That has not changed substantially so far in the first half year in the pipeline. And of course, we are e-commerce sided. So, everybody does have some part of e-commerce in their thing. So, we are somewhat e-commerce and everything to do with that, whether it is packaging, UPS, DHL, those type of outfits. So that is really driving it. But we do have some also, I would say, durable goods on orders. But if you want to take one slant, it is certainly more on the e-commerce-related – e-commerce and e-commerce-related fields.

Sebastian Growe — Okay. And on the previously struggling end markets or verticals, is there still something which is going wrong, or have these also recovered to certain extent?

Gordon Riske — I would say so far, so good. It was a great Q2 for the US team especially. It is over $1 billion. Cannot forget the exchange rate.

We have never had a $1 billion quarter. So no, our pipeline is okay. And that is why we are able to confirm the guidance.

Sebastian Growe — Okay. Thank you very much for that.

Omid Vaziri — Yes, good afternoon, gentlemen. I have two questions. I will take it one by one. First question, given the high level of demand, the suppliers are sitting on high chairs when it comes to negotiating price and delivery perhaps, what can KION do to reduce the impact or the exposure to external supplier bottlenecks there going forward? That is my first question.

Gordon Riske — I don't quite understand. To reduce our exposure to what now?

Omid Vaziri — So you are clearly facing supplier delivery issues, potentially higher prices being demanded by this -- from the external suppliers. What can KION do to reduce the impact or the exposure to external supplier bottlenecks going forward?

Gordon Riske — Well, we have a supplier development program. Again, I go back to the 40% in four years and typical German or European mid-sized companies. We have quite a large program to extend our reach. That was why we made the investment in the Czech Republic. That's why all of our efforts in China and so forth. So we do have a development program. We have also informed you as part of our Capex that we have spent money in Hamburg and Aschaffenburg in restructuring the factories to become more efficient. We are in the middle of that process. So, it is not just our external suppliers, also our internal suppliers and efficiency programs. And as I said, this year was quite extensive. I do not expect to have the same impact in 2019 because we will have cleared up some of the topics within that timeframe.

Omid Vaziri	Sure. Thank you, Gordon. But more specifically around the short-term resolution to this issue, what can KION do to perhaps negotiate better delivery from external suppliers, more short term?
Gordon Riske	Well, it always takes two. That is a little bit philosophical. It always takes two to come to a degree. I would say the supplier market, if you look at other companies in our field and related fields, everyone is facing certain issues with getting components, especially key components, whether it is's electronics out of Asia. We all have seen some slight increases in steel prices, things like rubber, and it sounds silly, but tires and so forth. So our whole effort is to have somewhat longer-term relationships with our tier 1, tier 2 suppliers and keep with the efficiency programs of our internal factories.
Markus Almerud	Hi, good afternoon. Markus Almerud from Kepler Cheuvreux. Couple of questions. So thank you very much for quantifying the supply chain cost. Could you also do the same thing with the raw material cost? So what was the impact from raw materials in Q2? And how do you expect that playing out in Q3 and Q4? And also, the same with labor cost, please. That would be very helpful.
Anke Groth	Yes, hi. The material cost effect, it is mainly related to steel and scrap steel. So we see here a higher single-digit million amount. And throughout the year, if you look at last year and the effect we have seen last year, it was around €25 million-ish. So you can take that effect going forward as a good proxy for this year as well.
Markus Almerud	Okay. And the labor cost?

Anke Groth	And the labor cost, you can easily find that in our Q2 report. For the labor cost I mentioned there, I think, in the English version, it is around Page 22 or something like that. So you can see the -- and find the number there without any problems.
Markus Almerud	Okay. Perfect. And then can I just ask on the --
Anke Groth	For some clarification issue, to be clear here, of course, the cost you see in the report is tariff and volume effect, so higher tariffs. And if you also see the number of employees, there is also a volume effect in the number as well. So it is both.
Markus Almerud	Okay. Okay. Perfect. And then if I look at material cost, so that is mainly in ITS. Is there nothing in SCS, or does the contract you have compensate for that?
Gordon Riske	That is project business. It runs a little bit differently there. We buy a little bit more than we do with the ITS. So that is more able when we do the contract, two-year contract, for a particular project, that is easier to accommodate.
Markus Almerud	Okay. Perfect. And then very quickly, if I can just ask, what is the average length of the SCS order book at the moment?
Gordon Riske	Again, the average what?
Markus Almerud	Length towards the delivery time for the order book or --
Gordon Riske	Yes, as I said, we have a mix of projects, as we showed on the Capital Markets Day, that goes from 12 months to 36 months. On

average, so somewhere between there, that is really tough to say what is the average. That changes every quarter.

Markus Almerud — Okay. Okay. Thank you very much.

Glen Liddy — Good afternoon. Could you give us an idea what the impact of all the delays has been on your working capital? If you are reworking things, presumably, things are staying in your factories much longer than normal. How much is that adding to your working capital?

Anke Groth — It is roughly €100 million.

Glen Liddy — And you would expect that to unwind by the end of this year?

Anke Groth — Yes, we do.

Glen Liddy — Okay. On also SCS, a huge surge in orders for the quarter. How -- what proportion of that do you think will be booked in the remainder of this year?

Gordon Riske — It is tough to say. It is certainly less than half because these things do -- as I said at the last question, we have some of these contracts 12 to 36 months. So that is not something you should take as it goes fully booked into it. We saw the weaker first quarter. And so not all the orders that we received in Q2 will be implemented. So they will not all be as what we call win and do. But nevertheless, it gives us enough backing to be able to confirm the guidance for SCS.

Glen Liddy	So your engineering resource that has been underutilized so far this year, will that reach normal utilization rates quite quickly, or will it be a slow builder?
Gordon Riske	No, no, no. They will be fully utilized.
Glen Liddy	Right. And on pricing, I appreciate you put your prices up for trucks once a year ordinarily. If you get further rising input costs, do you have the ability to raise prices? You have got a list price that you sell many things from. So can you change those during the course of the coming quarters?
Gordon Riske	We never or normally never have price increases through the year. We have done it one time. That did not work out so successfully. We will look at particular effects in certain regions. When the Brexit was announced and all that happened in the UK, we did have an extraordinary price increase, as did all other manufacturers. Right now, the US market, it is only 2% of our total, but since the steel taxes and so forth, aluminum, the general market has increased prices. All the manufacturers have increased prices to the market. And so we were following that. But as said, North America is a little special case. First of all, it is 2% of our units. But there was a price increase, and the first one already happening.
Glen Liddy	And when you get to the pricing for next year, will you try and anticipate further price rises in raw materials, or will you just be running behind and just recovering whatever you have seen this year?
Gordon Riske	Little early to tell. We go through that review as we go through our budgeting and review process sometime when we have our

third quarter numbers in, and then we will look at how the things develop.

Glen Liddy — Okay then. Thank you very much.

Anke Groth — And pricing always also depends on market environment, market conditions, and what competition is doing. So we are -- we have a good market-leading position in a lot of areas. But nevertheless, you also have to take market into consideration and how other companies are moving.

Glen Liddy — Okay. Thank you.

Denise Molina — Thanks. Just two questions. First, on the rise in personnel costs of 5% you have, part of that you said came from volume. So I am just wondering, if you look at the forklift business now, and it it is running at capacity, and if we aree expecting maybe to get back down to sort of more normalised rates growth in maybe next year or the year after that, do you have a sense of what portion of your employees you can -- are temporary that you would be able to I guess lay off, and how much variability you have in the cost structure on the forklift side?

And then on pricing, just to follow up on the pricing questions, I think just if you could comment on the pricing environment and whether or not you are seeing pressure on the forklift side because it seems counterintuitive that the demand would be so high. You are running at capacity, but you do not have pricing power.

And then on the SCS side, if you could just talk about project pricing because, in the last quarter, you mentioned that, for new projects, where it was a new warehouse and you did not have sort of a sense of how quickly that could be executed, that it was more difficult to get visibility on the margins. So I am wondering if that is improved.

Gordon Riske

Okay. Regarding personnel costs, our flexibility really depends on where you are. In the US, we have total flexibility, goes pretty quick. In Eastern Europe, also. In China, also goes pretty quick. We can move with the demand. In Europe, we have in some factories 10% or so of flexibility. That means temporary or on short-term contracts. So we do have solutions there. And if it really gets tough, in Germany, we do have the short-time work agreements that are used once in a while in those types of situations. So the bottom line is we do have flexibility there.

The second one, pricing power forklift, I think a very excellent question. Why couldn't you just double the price when the market goes so high? Fact is there is a market leader called KION with its brands Linde and STILL. And then there unfortunately are a few competitors. And then there are a whole bunch, especially in China with the market pressures and due to some of the tariff things with the US, every forklift that goes from China to the US is 25% more expensive after July 7th. And so it is not like they will start ramping down their factories. So we do have the case where the competition is still fierce. And we as a market leader try to stay at the edge of that and have price discipline.

When there are larger tenders for warehouse equipment, then there is quite a bit of movement up and down, but in general, we have a fairly disciplined market, at least here in Europe.

Question was project pricing for large orders. As I said, visibility, especially if we have some big orders, where we had in the first quarter the first part of that order, so the long-lead items, and of course, we know exactly what is going to happen with the second part of the order. But there has been really no change in anything there. We have also there competition that we have to look at. All I can say is we had a great job in the second quarter. So year-to-date, we are right on the way. And with that, we are able to confirm the guidance.

Daniel Gleim — Yes, thank you very much for taking my questions. There are actually two of them. The first one relates to the high single-digit euro amount. You gave us costs for the supply chain issues. My question is, is this the one-off cost only, or does this include an estimate for the forgone volume?

Anke Groth — No, it does not, no effect on forgone volume in it.

Daniel Gleim — Okay. The second question would be on the Supply Chain Solutions segment, the strong orders you had in the second quarter. Could you comment on the margin you have seen for those orders relative to current sales?

Anke Groth — Actually, we do not comment on the margin. If your question is hinting towards if we have made special prices to get the orders in, we can confirm that we have not.

Daniel Gleim — All right. Thank you very much.

Zexi Wu — Good afternoon, everyone. Just a couple of questions from me. First question is on the labor cost inflation. So we have seen about €15 million labor cost inflation. Just wondering how much of that did you manage to compensate within the cost savings or other measures. That is the first question.

Anke Groth — So the pure labor cost increase was included in our guidance. That is what we have commented. There is not only one special items where we have, of course, countermeasures. And you see other efficiencies coming through. So there is no particular cost-reduction program related to our labor cost. And yes, let's leave it there, please.

Zexi Wu — Okay. Thank you. Another question is on margins for second half. Just wondering, could you just give us a brief summary? What are the key elements you see or drivers you see that could drive us -- that could make us more confident about second half margins? What are they moving forwardespecially?

Gordon Riske — Well, the first part is easy: just get the trucks out the door. We have lots of trucks here three-quarters finished. So that is the main part is get the trucks out the door. And as we have said in our written comments, the underutilization of SCS, now the factories and engineering is full. So that is the second part of it is the utilization of the capacities that we have to get the jobs done.

Operator — And I hand back to Mr Gordon Riske for closing remarks.

Gordon Riske — Yes, thank you, all, for participating in the update call today for the second quarter. And we look forward to our third quarter numbers in October when we have the next update call.