KION GROUP AG

Q3 2018 Update Call

Conference Call Transcript

25.10.2018

15:00 CET

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Anke Groth (CFO)

Gordon Riske

Thank you and welcome to our update call for the third quarter 2018. As a basis for this call, we would like to use our Q3 2018 presentation. It is available on kiongroup.com under Investor Relations in the Presentations section.

We'll be presenting in 4 parts today during today's call, and we will then open up the discussion for your questions. I'll begin with the strategic and financial highlights of Q3 2018 followed by a market update. Anke Groth will then provide you with a financial update. And then we will close the call with the confirmation of our outlook for the full year 2018.

So let's get started on Page 3. We have summarized our strategic highlights for Q3 2018. With our annual results back in 2017, we did publish our updated strategy KION 2027. Along its fields of actions, energy, digital, automation, innovation, and performance, our brands introduced highly innovative products during the third quarter 2018. We're showing here some selected examples on this slide. Unlike other industries, food distribution has not been a traditional market for robotic automation yet. A large supplier in this sector selected Dematic to design and implement a new robotic solution especially developed for cold temperature-controlled environments.

Linde closed the last gap in the portfolio and now offers lithium ion trucks in the load category range from 6 to 8 tons, a load category very few manufacturers offer electrified forklifts for. Linde also introduced new functions for its connect fleet management system. The digital applications zone intelligence and truck mapping utilize various technologies to make the use of industrial trucks even safer and more transparent.

And STILL launched a unique multifunctional tractor with a liftingfunction. In a tugger train or tractor application, it effortlessly pulls trailer loads up to 5 tons and lifts loads up to 1 ton on its folding forks. It's also available with lithium ion technology for maximum availability in multishift use.

Turning to the next page, these new products and service innovations under our KION 2027 strategy further broaden our resilient business mix. And I'm on Page 4 here. Today, KION serves a much broader customer base across both segments. E-E-commerce is a growth driver across all of our activities and adds a structural growth momentum. The strong growth in electric and warehouse trucks over the last years and the acquisition of Dematic have made us less exposed to cyclical fluctuations.

In addition, our very strong service business is stable and resilient. Services today represent 43% of group revenue and even 49% of our ITS segment revenue. Even in more difficult times, our service business remains stable and highly profitable.

So in summary, through the acquisition of Dematic, which is roughly 25% of group revenue in the Supply Chain Solutions segment, this segment is far less cyclical business to start with. Of the remaining 75% revenue, that is the ITS, half of this is in stable service activities. And if you look at the new truck business today compared to many years ago, this business which represents 35% to 40% of the revenue, 80% of the new trucks we sell today are electric in-warehouse trucks. So that is quite a shift in the past 3 to 4 years, moving KION to a less cyclical business model to a more stable structurally growth-driven business model with a high level of services.

And that brings me to the core of our financial highlights today on Page 5 for Q3 2018. We saw a strong, very strong order development across both segments and are today presenting solid Q3 2018 results. Despite continued headwinds, this allows us to confirm our outlook for the full year 2018.

Regarding the top line, order intake for the KION Group grew strongly by 11.5% to €2.1 billion, and revenue grew by 3.5% to €1.9 billion in Q3 2018. The industrial Truck and Services segment, ITS, increased its order intake by 7.6% to €1.5 billion, and its revenue grew by 8% to €1.4 billion. The Supply Chain Solutions segment, SCS, with its project business showed another very strong order intake in the quarter, increased its order intake by 21.5% to €598 million. Revenue declined by 8.5% to €473 million due to the lower order intake from the segment in earlier quarters.

Regarding profitability, the group's adjusted EBIT margin declined slightly to 10.2% compared to 10.7% last year, reaching adjusted EBIT of €193 million for Q3 2018. The ITS segment continued to see production inefficiencies from delivery bottlenecks at selected suppliers, although we are making steady progress, as well as headwinds from material costs and labour cost. Segment margin of 11.1% was therefore slightly below prior year. The SCS segment margin declined to 9.3%, still impacted by underutilisation of its project-related capacities resulting from a lower order intake in the earlier quarters.

Net financial debt increased to €2.2 billion compared to €2.1 billion at year end 2017 due to temporary working capital financing. And free cash flow in the first 9 months of the year was

€107 million and thus below prior year level mainly due to an increase in inventory and tax payments.

Let me move onto the market update. On Page 7, we're focusing here on industrial trucks. And it shows the global market development by region in the third quarter. Western Europe continued to show strong growth of 13%, in particular from small entry-level warehouse equipment. Eastern Europe grew even at 21%, again displaying strong growth in most key markets. China saw continued and somewhat normalised order intake growth of 12%, driven in particular by demand for electric trucks and warehouse equipment. North America grew at a slower pace of 3%, mainly due to price increases by OEMs to compensate for material cost headwinds and tariffs. South and Central America remained volatile and declined by minus 6%. Let's see what happens with the elections on Sunday. As a result of these regional developments, the global market grew at around 10% in Q3 2018, thereby maintaining a very good growth momentum in the third quarter.

On Page 8, we're comparing this growth with KION's market growth in the industrial trucks by region. In Western Europe, KION saw a growth of 6% in Q3, below strong market growth, in particular from smaller warehouse equipment, entry-level warehouse equipment. And when we talk about that, we're talking about what was formerly known as manual hand pallet trucks being replaced by low-cost electric hand pallet trucks, not one of our big suits. Energy -- excuse me, Eastern Europe grew by 16%, also slightly below with a strong growth in IC trucks. China KION growth accelerated to 14%, driven by electric and warehouse equipment, and thereby growing above the market and remaining well positioned to benefit from the shift towards electrically driven trucks. North America KION grew by 22%. Keep in mind that, in Q2 2017, this included a one-time positive order effect following the new product introductions at ProMat trade show in April 2017, which of course impacts year-to-date growth rates. South and Central America, KION declined by 5%, in line with a very volatile market in Brazil. But overall, we saw a good Q3 with global unit growth of units order intake of 8%.

Let me also briefly comment on the development in the market for Supply Chain Solutions. As you know, there are no market statistics for Supply Chain Solutions. Continued customer demand and our strong order intake in Q3 2018 once again support that the market for automated systems sustains in growth momentum and that underlying growth drivers and trends do remain intact. Dematic, as the global leading player in this field, is best positioned to capture this growth.

With this, I'd like to turn it over to Anke, who will now present the financial update.

Anke Groth

Thank you, Gordon. Turning to Page 10, you will see the key financials for Q3 2018. Order intake grew strongly by 11.5% to around €2.1 billion, supported by a strong order development in both segments. The order book at the end of the quarter stood at €3.2 billion, a record value, strongly above year end and also above the level after the first 6 months of the year. This is an excellent foundation for next year.

Revenue grew by 3.5% to around €1.9 billion. Adjusted EBIT declined to €193 million, which results in a margin of 10.2%, below Q3 2017. EBIT was impacted by continued delivery delays at selected suppliers in industrial trucks, underutilisation in

Supply Chain Solutions, as well as headwinds from material costs and labour cost increases. I will come back to these issues with more explanations later in the presentation.

Net income was €96 million, was significantly by 21.8% above the previous year, driven by reduced PPA items and lower non-recurring items relating to the Dematic acquisition. Overall, we saw continued headwinds weigh on our operations but, at the same time, a continuation of the very strong order momentum.

Let me turn to Page 11. And you will see the key financials for the first 9 months 2018. Order intake grew very strongly by 11.8% to €6.4 billion. Revenue grew by 2.4% to around €5.8 billion. Adjusted EBIT declined to €538 million, which represents a margin of 9.3%, impacted by negative FX translation effects as well as ongoing headwinds. Net income was €244 million, was 9% above prior-year level. Overall, revenue growth and adjusted EBIT were still impacted by headwinds. Order intake was extremely strong.

Let me continue with the key financials for the segment Industrial Trucks and Services on Page 12. I comment on the quarterly figures. Order intake grew by 7.6% to €1.5 billion. Revenue showed a similar growth momentum of plus 8% to €1.4 billion. Adjusted EBIT grew by 4.8% to €157 million, equal to a margin of 11.1%, and thus only slightly below a margin of 11.4% in Q3 2017.

As already stated with publication of our Q1 and Q2 results, we continued to see delivery delays at selected suppliers, which led to production inefficiencies at our factories with the main focus in Europe. We have received many questions over the last months.

So let me give you some more context, as this is indeed the major issue.

The market and industry have been performing well for several quarters or even years in a row so that demand is high, and supply chains at selected suppliers are stretched. As a result, we are seeing delivery delays from individual suppliers. These delays lead to the fact that trucks cannot be shipped out of the factory because of missing parts. The trucks very simply cannot be entirely assembled. This do cause high inventory levels and missing revenue.

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. This leads to inefficiencies in production and higher costs. In Q2, these additional costs amounted to a high single-digit negative EBIT impact. And you should assume a similar level for Q3.

We have, of course, initiated countermeasures, which are proving effective. We are working closely with our suppliers to catch up on the delays over the rest of the year and should have the majority of issues resolved by year end.

In summary, yes, we are still facing headwinds. We are still facing inefficiencies in Q3. And we will continue to see those headwinds and inefficiencies also in Q4. But as said before, issues should largely be resolved by year end with some back-end loaded volume effects from higher utilisation in production towards the year end. Overall, our countermeasures against supplier bottlenecks are on track. And as a result, we saw an acceleration in segment revenue and adjusted EBIT in the third quarter of the year.

Page 13 summarizes the key financials for the segment Supply Chain Solutions for the third quarter. The segment saw another strong order intake of €598 million in Q3 2018, up 21.5% compared to Q3 2017. Revenue declined by 8.4% to €473 million, still impacted by the lower order intake in earlier years.

Let me specify this. In the press release and report for Q2 and Q3, we stated that we saw delays in the awarding of projects in previous quarters. This refers to the weak order intake in Q1 and the first 3 quarters of 2017. Given the strong order intake in Q2 and the continued good demand in Q3, the order book for the segment has grown so that we expect some additional revenues from the new projects we have won in Q2 already in Q4 of this year.

You know that the delay between order intake and revenue generation can vary significantly, depending on the specifics of the projects which have been awarded to us. But as said, we expect additional revenue from the projects won in Q2 already in Q4 of this year.

Adjusted EBIT was €44 million in Q3 2018, thus resulting in a lower adjusted EBIT margin of 9.3% compared to the 11.9% in the third quarter of 2017. Profitability was impacted mainly by the lower level of revenue, which resulted in continued underutilisation in Dematic's project-related capacity.

We gave you the information that, in Q2, the underutilisation resulted in a high single-digit negative EBIT impact. And you should assume a similar level for Q3. Again, for Q4, we expect additional revenues from the projects won in Q2, which should drop through to the EBIT line. Dematic's leading position and the prospects for next year are clearly underlined by the strong order intake we have seen in Q2 and Q3.

Let me turn to the next page. Page 14 shows the reconciliation from the adjusted EBITDA to the net income for the group. Let me highlight selected items, nothing new for you, main effects haven't changed. As explained, adjusted EBIT was impacted by headwinds. PPA items related mainly to purchase price allocation amortisation for Dematic. Net financial expenses reflect, among others, a positive FX impact in 2017 from a US dollar intercompany loan related to Dematic. And as explained in the last quarter, this effect will not occur in 2019, as we adjust some legacy structures. Overall, net income was significantly above the previous year, and earnings per share are now at €2.09.

If we are turning to the next page, you see the details on the free cash flow. Free cash flow to the firm was €107 million for the first 9 months of 2018, below prior-year level. Changes in net working capital resulted from the increased inventories due to the already mentioned and explained delivery delays at selected suppliers. Increased inventory levels were upset by advanced billings and billings in excess from the Supply Chain Solutions segment, based of course on the good order intake. Main driver for lower free cash flow were higher tax prepayments due to higher results in previous quarters. And Capex is higher as well, as we continue to invest into our factories.

In terms of outlook for the full year, keep in mind that we usually generate strong free cash flow in Q4 and that the inventories from supplier bottlenecks should be largely reduced and the trucks shipped out to our customers.

Page 16 shows the net debt of our business. As at September 2018, net financial debt of €2.2 billion is slightly above €2.1 billion as at year end. Net financial leverage of 1.5 remains almost unchanged compared to December 2017. Leverage on our industrial net operating debt at the end of September '18 was 2.7.

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

Gordon Riske

Thank you. I'm on Page 18. So based on the presented figures for the first 9 months of 2018 and despite some of the mentioned continued delivery bottlenecks at some selected suppliers, for our segment Industrial Trucks and Services, we confirm our outlook for the full year 2018.

We have reported headwinds in Q3, and we will continue to see some of those in Q4. We have defined countermeasures which are showing to be effective but will certainly not compensate all of the negative effects. As a result, for the adjusted EBIT line, we may come out in the lower half of our guidance range, as explained before. Actual business performance could deviate from the outlook. This depends particularly on macroeconomic and industry-specific conditions and may be negatively affected by increasing uncertainty or a worsening of the economic and political situations.

Looking onto Page 19, you'll see our financial calendar. The next event is the presentation of our full year 2018 financials on the 28th of February 2019. In the meantime, we will be presenting at conferences and roadshows and are looking forward to continuing our personal dialogue with you on these occasions. So with this, we'd like to close the formal part of this update call and turn it back to the operator so that we can answer and 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.
Sven Weier	Yes, good afternoon. Thanks for taking my questions. The first one would be regarding the order intake in SCS. You now had a much more steady development in Q2 and Q3, quite impressive order intake. I was just wondering. Last year, when you had some issues, you were mentioning that part of the reason was not only the lumpiness in orders, but you also lost some market share because of the issues in Monterrey you had. Is the strength now also a reflection that Monterrey is running seamlessly and you're gaining back some market share, and it's not just positive lumpiness that we see that the moment? That would be question number one.
Gordon Riske	Yes, we are a leader in the market, and we do see strong demand. Certainly, when customers have better performance, and that is the case, and Mexico is performing much, much better, that helps everything out. It's without question.
Sven Weier	Okay. And then with regard to the guidance, obviously, you repeated your comment regarding the EBIT, in which half it would be. I was just wondering if you could so something similar with the order intake. Is it there fair to assume to be in the upper half of the range?

Gordon Riske — Sven, I think we've had a good run now first 3 quarters, and it gives us the very good confidence, order intake, to confirm our guidance very solidly.

Sven Weier — Okay. Thank you.

Felicitas von Bismarck — Yes, thank you very much. The first question would be on the SCS business in terms of the revenue development. You were mentioning it depends very much on the patterns in the projects and when they're coming through. But just when you did the guidance, in general, was this whole thing surprising to you? So is this underutilisation surprising, or was that all that you realized from the beginning it would take time for these purchase to come through?

Gordon Riske — Yes, we know some of these projects take time to come through. It's not such a surprise. The underutilisation, we have engineering skills that we've built up over the years. Those are very rare skills. And right now in the job market globally, we have to do whatever we can to keep the good people onboard.

Felicitas von Bismarck — Okay. And the other question I had was on the supplier issues that are burdening your industrial trucks business. This seems to be a very general industry-wide kind of issue. Everyone is talking about it that there was too much demand over the last couple of years and that they did not adjust their capacities. So for me, the question is rather, what makes you so sure this is not going to be an issue for 2019 or even further out?

Gordon Riske — Yes, we have beefed up our supplier development team in the past months, kind of in line with our KION 2027 strategy, which we have very specific growth targets in '19 and '20. So on the supplier side, I think we are with some very dedicated programs in a good way. We also have our own internal processes and capacities to extend. And as you know, we've talked about our investment programs in our European facilities. We opened up the second factory for Dematic in Europe. So all of those are exactly done to make sure that we can continue our solid growth path, despite some shortcomings on some suppliers. But we feel confident that we have made improvements. And you see it in the Q3 numbers. And it will continue.

Felicitas von Bismarck — Okay. But just as a clarification, you don't think it's a more structural issue, or is it that you have countermeasures in place that goes against these structural issues?

Gordon Riske — We have countermeasures in place against the structural issues. But in our business alone, if I look at our own numbers, we have a CAGR I think of 11.1% over 5 years. Now you know in Europe and especially Germany, there's a lot of so-called Mittelstand, family-owned companies, that do ask questions of investments going forward. And so those are some of the structural measures that we're talking with those and helping to make sure those investments do take place.

Felicitas von Bismarck — Okay. Thank you.

Philippe Lorrain — Good afternoon. Philippe Lorrain from Berenberg. Two questions also from my side. Is it fair to assume that you already managed to get part of these trucks which were previously delayed with the issues on the component side already out of the door, as hinted by the acceleration in between the sales growth in Q3 in ITS? You could do -- I calculate with something like 13% increase in new business revenues. Is that correct to assume that part of that is really due to the fact that you managed to get these trucks out of the door?

Gordon Riske

Yes, sure, we shipped more, absolutely. Things are getting better. We're producing more per day than we've ever produced before. But still, we have some catchup, and you see it in our inventories and so forth. They're still high. So with unfinished or semifinished goods, still some ways to go.

Philippe Lorrain

Okay. Great. And the second question is on SCS. The current guidance for the low end is implying basically 16% year-over-year revenue growth in Q4, which is stable sequentially versus Q3, and an adjusted EBIT margin of about 10.4% on my calculations, so notable acceleration versus Q4 last year and also versus Q3 this year. I do appreciate that there is similar pattern, let's say, to the order intake development here. Is it fair to assume that, with the current backlog that you have in SCS, we should plug in these kind of numbers into our models going forward?

Anke Groth

Yes, to give you more guidance or answer on that one, the low revenue in Q2 and Q3 in SCS, you could assume that that could put our revenue guidance at risk if you do the year-to-go calculation. But revenue in this year will be generated from currently ongoing projects as well as from new projects now that we received as orders in this year. And as I explained during my presentation, some orders which we received in Q2 we will already start to convert and turn into revenue in Q4 of this year. So on this basis, we confirm our guidance. And the revenue in Q2 or the additional revenue in Q4 from Q2 will also drop through to the EBIT line.

Philippe Lorrain

Okay. Great. Thank you.

Ben Uglow

Good afternoon. Thank you for taking the questions. I had a couple. First of all, Gordon, can you just give us a sense of how you are thinking about the price environment in truck as we move into 2019? Do you see a scenario where price-cost, you might have a little bit more flexibility around that in 2019 than we did on 2018? That's question number one.

Second question, just for clarification on the SCS margin, is this all basically underutilisation, or have you seen any significant change at all in pricing conditions? Is this really about volume as opposed to price?

And final question, could you just give us a bit of feeling or colour of what you're seeing in China right now? We've spoken to a lot of companies today. Some are saying steady as she goes. Some are seeing some form of deterioration. How do you see the China truck market over the next few months?

Gordon Riske

Yes, on pricing, I would also say steady as she goes. And we've done it in past years mid-December. We've got all our teams lined up to continue this year. I don't want to jump ahead on the exact heights that you've seen around the markets, especially in North America, since the tariffs have been increased, steel and aluminum. Everybody's increased their prices kind of to go along with that. But we still have a high competition in Europe and around the world. So steady as she goes. We will make our price increases as we do towards Christmas season every year. And I think that will be continued.

I'll take number three also, and Anke will give you an update on SCS underutilisation. But on number three, China, we saw 12%

growth. The 30% is quite unusual. And I think no one expected that to be the norm. And first of all, it's not possible to deliver that and manufacture that. And there's -- in China is ups and downs, but the continued growth, we do expect that this topic of warehouse e-commerce, electric trucks, the seriousness of the government to get rid of combustion engine-driven trucks where humans are working. So we see it as still an excellent environment for our continued growth in China and fitting very well with our strategy to concentrate on higher-value trucks, mainly electric in-warehouse trucks.

Anke Groth — And then referring to your second question, so you asked on the SCS margin and if underutilisation is the only reason. The reason is that we have lower revenues and we have an underutilisation which is caused by the weaker order intake in Q1 and 2017 as explained.

In addition, it always depends on the projects we are working on. So there might be also a slight project margin mix. But that is -- really, the underutilisation is one of the main reasons I would say.

You have asked for pricing. Yes, no, there is no issue with pricing conditions in SCS.

Ben Uglow — You're probably bored of hearing this, but it sounds to me as if the mix of orders that you see in SCS, and obviously particularly in 2Q, that's partly what's making you confident around the 4Q outcome. Is that a fair assessment?

Anke Groth — That's an absolute fair assessment, Ben, yes.

Ben Uglow — Great. Thank you.

Sebastian Growe

Yes, good afternoon, everybody. Three sets of questions. The first one would be on ITS. I'm sorry boring you again with -- or poking you with the supplier issues. I would just be interested in a feel for the affected shipment, i.e. the volume that is behind it. So my calculations, it might be around 5,000 units, which you can comment on that.

And when talking about commenting, Ms Groth, you said that the gross impact from the supplier issues is expected at high single-digit number in quarter 4. Against that, you will have the volume flush out from just releasing the inventories. So net-net, I think it should be a positive. So if you could just clarify, that would be helpful.

And on the countermeasures, I understood you have been patiently waiting for these selected smaller suppliers to ramp up their capacities, but in parallel also going more intensively for additional and new suppliers. Could you just share some thoughts on that aspect with us? That would be helpful. And then I have another one on Supply Chain Solutions in a second.

Gordon Riske

Okay. No, you don't bother me on supply issues at all. I love our suppliers. So I've spent more time with them than I've actually expected to. But anyways, we are working very closely with suppliers. And on some forklifts, we're 215,000 forklifts now. 2013, we were at, I don't know, 145,000. So it does give us some better leverage today, we do try to have dual suppliers, to kind of like a 70/30 combination to keep everybody honest. But with the volumes that we're seeing and predicting for the future, it does give us some flexibility. And yes, we are looking at additional supply base to the ones that we have today. So absolutely, with those volumes, it gives us that optionality better.

The number of units, your calculation probably isn't so far away. That varies a little bit on product type and location. But it is a number of trucks. And we said with the delayed revenue was around €100 million. And the same number could be a reasonable assumption for Q3. So you're not so far off.

Anke Groth

Sebastian, you have had a third question, haven't you?

Sebastian Growe

Yes, exactly. So the question that I had to you specifically, Anke, was on the net impact from the supplier issue. I think you were referring earlier on to the gross impact on the headwind side. It was a high single-digit volume, you said, for quarter 3. And the same amount should be expected for quarter 4. But the net figure would be of interest for me.

And the other part is more related to Supply Chain Solutions. So here, it's a twofold thing. So one question I have is on the verticals. To my understanding and what you disclosed at earlier capital market days was that food and beverage was a good 10% or so of the total Dematic or Supply Chain Solutions business. Is it fair to say, and also because you indicated on Ben's question that the mix has been rather positive in the more recent past, that you're just looking more aggressively, if I may phrase it this way, at the food and beverage space on the one side?

And the second question I have is on the regional development, if you could give us at least an indication where you see the strongest incremental growth, absolute sales growth between the

Americas, between APAC, and then lately the EMEA region, that would be very helpful. Thank you.

Anke Groth

Let me first comment, and then Gordon will take over regarding the impact of the supplier bottlenecks. We don't comment on gross or net. We have said, yes, it's a high single-digit effect when we have spoken about Q2. And we gave a clear guidance that the Q3 effect has a similar order of magnitude. I think I would like to leave it there, Sebastian.

Maybe regarding the -- and maybe it was not clear -- Ben's question because I elabourated on it. Ben asked if the underutilisation is the only reason for the lower revenues, lower earnings in SCS. And I said a little bit has to do also with the project mix because you have projects with higher margins and so on. So it really depends on the projects we are working on, but that is only a minor effect. The majority is from the underutilisation. That is what I tried to convey when I answered Ben's question. I hope that clarified it now.

Gordon Riske

On the SCS, there's been no real change. The food and beverage, the 10% or 11%, that's an interesting market. And as we've showed with the robotic cold storage, also interesting aspect going into that market, not typically where you put robots in. So it's an attractive segment we are investing in. But there has not been a real change. Same with the regional distribution. We had a very strong North America again. But also, Europe had a good contribution. We're seeing some good activity in Asia in the pipelines, the order pipeline. The project pipelines are very well filled around the world. But there's no real, let's say, regional twist that we say, all of a sudden, I don't know, Spain is ordering like crazy. That's not the fact. So it's very similar, but we're on a good run. I would call it that.

Sebastian Growe

Okay. Sounds good. Thank you.

Jack O'Brien

Hi, thanks for taking the questions. A couple from my side. Firstly, obviously, you've hinted that revenues should come through fairly strongly in SCS. But just a question on risk to your free cash flow guidance, obviously, fourth quarter tends to be a fairly strong quarter for free cash flow. But what do you think the risks are there, given the cash flow generation through the first quarter?

And then just the second, obviously, you've talked about the fact of underutilisation and so on. But on the material and labour inflation, if you could just for the record scope what you've seen this year, that would be very useful. Thank you.

Anke Groth

Yes, hi, Jack. Regarding free cash flow, yes, we have explained that's mainly due to the bottlenecks, at selected suppliers. The free cash flow in the first 9 months was lower compared to the prior year. Liquidity was temporarily affected by the increase in working capital. And as also explained before, we plan to largely resolve the supplier bottlenecks by the end of the year. And we usually generate more cash flow in the fourth quarter. So yes, on this basis, we confirm our guidance. You're asking for risks, yes, we have to get the trucks out the door. But as explained before, we are heavily working on it, and we are confident that we'll reach our cash flow guidance.

With respect to the labour cost and the material costs, let's start with the labour cost because, yes, we haven't elabourated specifically in our presentation on that point. So in H1, you could see the €50 million effect of higher labour cost in our report. And I would say it's very reasonable to extrapolate linearly from Q2 to come up to a good estimate for an increase in labour cost also in Q3 and then in Q4.

And with respect to material costs, you know that it's steel and scrap steel normally which is influencing us. And we said in the call which we had regarding the second quarter that we had an impact of a high single digit. And we also said that, in total, for the full year, the effect may be at the same level than in 2017. So in 2017, we had reported €25 million, which you can grossly split evenly across the quarters. And I would say you can also take the reasonable assumption that we are coming out a little bit less than last year.

Jack O'Brien

Great. Thank you very much. And perhaps just a couple of housekeeping, given all the other questions we've had. Tax I noticed was about 32% through the first 9 months. Obviously, tax rates globally have been coming down. But just any thoughts there? And secondly, for PPA, I think I had €100 million in for '18. Obviously, you're at €97 million after the first 9 months. Just any colour you can give on how I should think about PPA coming through in the next few quarters.

Anke Groth

Yes, sure. Let's do housekeeping. Tax rates, we have always guided for an effective tax rate of between 30% and 35%. And following the US tax reform and a smaller increase in effective tax rate in Q2 and now in Q3, we would still assume that we end up around the lower end of the guidance range. So we are completely within our guidance, and we still firmly believe that we will come out at the lower end of our guidance range.

PPA, yes, PPA we guided around -- for the full year of around €100 million pretax related to Dematic, and we always guided and said thereafter it will be around an €80 million, and that also still holds true.

Jack O'Brien — Okay. Brilliant. Thanks for the help.

Zexi Wu — Hello, good afternoon, everyone. Thank you for taking my question. Well, I think the first question from my side is, what's your growth outlook for next year? I think you mentioned in last quarter saying that it should be around mid-single digit normalised level. Just wondering how much visibility you have right now for reaching that growth.

Gordon Riske — Yes, right now, we're kind of working on getting our forklifts out the door in Q3. So guidance for 2019 and growth, we'll do that when we release the numbers and so forth in 2019. But we have informed midterm growth levels in our annual report that we expect on the industrial trucks. It'll be about 4% or so in the midterm, and on SCS, so mainly the Dematic business, around 10%, and no change to that.

Zexi Wu — Thank you. And also, on the trade war or tariff issue, I think, last time, you mentioned there something around a low single digit million impact on your profit. Is that still valid?

Anke Groth — That's absolutely still valid. You know that the tariffs on imports from China are affecting our ITS business, where we ship our trucks and truck kits from China to the US for the final assembly. But we always put this into context. North America business for the ITS segment accounts for 2% of the segment revenues in 2017. So it's a very minor part of our overall revenues. Yes, and in terms of EBIT impact, we expect to see a low single-digit negative impact from the increased tariffs, which will now materialize in the second half of 2018. And I know you will be eager to hear about 2019, but we will provide further details about that with the full year results.

Zexi Wu

Okay. Great. And also, maybe one last question on the SCS business. Well, clearly, the underutilisation issue is the main drag right now. Just wondering, when are we expecting it to be dissipating in the future? Is that fair to say it's going to dissipate probably in next year completely, given Q4, you still have some -- probably still have certain extent of underutilisation, and probably starting from first quarter next year, you're going to see this issue more or less gone?

Anke Groth

Yes, it's -- and I think that is also what you're assuming, and you are absolutely right to do so. You can assume a delay by several quarters. That's always depending on the project mix. I think we have explained that. We should see utilisation normalise as we start to work on more projects now and generated in Q2. And also, the order intake in Q3 is very good. So yes, it will normalise based on that one.

Zexi Wu

Okay. Great. Thank you. That's all from my side.

Omid Vaziri

Yes, thanks for taking my questions. My first question is in relation to -- we've been seeing labour capacity tightening in Europe, but also in North America. Could this cause near-term issues for you as you adjust capacity to deliver further growth?

And my next question is focused on the forklifts market and more specifically on the Western European forklift market. We've seen a strong return and acceleration in order unit growth in Q2 and Q3 this year. Certainly, after a weaker Q1, but also Q2 and Q3 were stronger than Q4 '17. And the question is, how much of this is delayed investments, the pent-up demand from weaker Q1 especially, or is -- and how much of it is because of the pickup in demand in warehousing equipment, especially entry-level warehousing trucks?

And finally, my last question is, do you see a trend here that a lot of large customers within the warehouse automation space are starting to develop in-house systems? We've seen examples with Ocado, XPO Logistics, and Amazon all developing in-house solutions. And some such as Ocado have even sold that solution onto the market to others. Thanks.

Gordon Riske

Yes, labour is getting tight everywhere, but we do assemble. So I don't see that as a top issue. Certainly, as we invest in factories, we are investing more and more in automated, automated welding, and so forth, so using robots. I think that's going to happen as a trend. So the labour shortage on the one side, yes, we have to work a little harder to keep the best people. But in the other side, it is really helpful for the sale of our mobile automation products around the world. So I see that as a real opportunity to take simple, easy work that was done with people driving forklifts or simple lift trucks with automated warehouse.

The forklifts market in Europe in Q2, Q3, yes, very strong, but as I said in my initial opening comments, a lot of that is driven by low-cost entry-level trucks. Nonetheless, even if you strip that out, it's still been a very solid growth market. I don't think it's a delayed investment and so forth. It's just the investment in e-commerce and so forth.

Regarding the trends of large customers, some of these big customers have always had their own departments for some specialized logistics operations, whether it be Amazon, which purchased Kiva and now calls it Amazon Robotics. Part of that they've kept themselves and developed themselves, have not sold it to others because they do believe it's a strategic benefit and competitive advantage. Ocado, interesting, yes, some interesting technology.

And so I think we'll see no real change. Companies will always do some investments because they want to have a -- perhaps a unique solution. But overall, we see just as many companies and big companies coming to us and asking to work closely with us, having -- especially for large projects. It's not so easy, as I said on other calls, to put 20-some kilometers of automated conveyer and sortation systems and get that up and running. It's one thing to build a product. It's a completely other thing to install it, to run it up, and to make it work for 20 years. So we see both sides. I don't see a general trend there that our customers are now becoming our competitors. I don't see that.

Omid Vaziri — Okay. Thanks very much.

Denise Molina — Hi, thanks. I have two questions on China actually. And they're both related to SCS. But was wondering, with respect to the market, have you seen any change in terms of orders and demand? Has it stabilized or picked up there? It seems like it's a pretty early-stage market, like everywhere else for warehouse equipment.

And then the second was related to just the synergies between the two businesses in China. Do you see any cross-selling? Have you had any success in cross-selling forklifts to your warehouse equipment customers or vice versa?

Gordon Riske

Yes, whether -- I wouldn't call China early. Alibaba and jd.com are very advanced, very serious companies in China, very strong, strong players, some of our biggest customers. So that market is progressing, perhaps not the heavy usage of fully automated equipment because labour rates and so forth are a little bit different. So we see China certainly on a fast-track growth. It also shows in the forklift business last years that China went from 20%, 25%, now getting close to 30% of the global market in units worldwide. So that's a trend that we definitely see.

Synergies, ITS, SCS, both units or segments are working closely together. It's regionally a little bit different. In the US, we are working closer to closer, using Dematic facilities as sales locations for the forklift people when we approach certain customers. And sometimes, we have a key account approach. In Europe, it's a little bit different. Linde and STILL have a much broader sales network. And in China, they work hand in hand, even there with our shareholder Weichai Power, sometimes helpful to open up doors for SCS to get into customers that perhaps alone may not have been as easy. So yes, we are seeing more cooperative work between the two segments on the selling side.

Denise Molina

Can I just ask a quick follow up? What do you -- how would you compare the pipeline in China this year versus last year for SCS?

Gordon Riske	Quantitatively difficult, I don't want to give too much of a projection. Qualitatively, I would say it's better, but we have made some changes in the people. So we've kind of upgraded our salesforce, management team about 18 months ago, and that's showing effects.
Denise Molina	Okay. Thanks very much.
Sebastian Ubert	Yes, good afternoon, ladies and gentlemen. One question left from my side. Can you please remind us on the progress you are having at your Czech Republic plant with regards to the Dematic equipment you started to manufacture this year? And what should we assume as kind of ramp-up cost that has hit this year's profitability and that might not recur next year? Thank you.
Gordon Riske	Yes, everything on schedule. We said we'd ramp it up through this year. So I did enjoy taking customers through there and seeing their smiles on their faces that they're glad that we have a strong European manufacturing base to serve the European customers. That's all on track. And we expect, as volumes come in, more and more, we'll be shifted to the European Stříbro plant for the European customers. That's fully on schedule.
Sebastian Ubert	Okay. That's good. And cost wise, what is a rough idea for the ramp-up phase this year?
Gordon Riske	We haven't given a quantification of that. But it's not such a substantial number that it would make a big difference.
Sebastian Ubert	Okay. Thank you.

Martin Wilkie — Thank you. It's Martin from Citi. Thank you for taking the question. Just wanted to come back on your comments in the opening remarks about how the truck exposure has tilted towards warehouse and electric trucks, and therefore, that should dampen the cyclicality. But obviously, for your truck business, only still a minority goes into sort of logistics and e-commerce type of environments, but probably less than 20%. So you've still got -- albeit the themes are still with regular industries. And given now that we've heard quite a few companies talking about fears in Italy, things like that, are you getting a sense at all that European customers are pausing on investments? Obviously, the order intake's been very good. But just in terms of your conversations in terms of if there's any sort of hesitation from the orders, would be fascinated to get your thoughts on that. Thank you.

Gordon Riske — No, really, we don't. I agree. There's a lot of noise, whether it's Italy, whether it's tariffs and everything else, trade wars, etc. But no, we don't see that. And the order activity, customer activity is strong and staying strong. And the topic about cyclical/not cyclical, the Dematic business is a little different, and as I said, we've shifted the forklift business, don't forget, in the last couple of years. This year again will be for the KION side another 200,000 forklifts in the population, last year, 180,000 in the population, and so forth. So if you look at the last 4 or 5 years, we've really added to our population. And most of those trucks are within the service of our own organization, used trucks. That really is a stabilizing factor.

Martin Wilkie — Okay. Thank you.

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

Gordon Riske — Yes, thank you all for participating and all of your questions. And we look forward to our next update call for the full year 2018 results.