KION GROUP AG

Q1 2020 Update Call

Conference Call Transcript

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Gordon Riske

Yes, thank you. Welcome to our update call for the first quarter 2020. As a basis for this call, we'd like to use our Q1 2020 presentation. It's available on kiongroup.com under Investor Relations in the Publications section.

We will be presenting in three parts during today's call, and we will then open up the discussion for your questions. I'll begin with our financial key figures of Q1 2020 and even more importantly with an overview on our COVID-19 measures. This will be followed by a market update. Anke Groth will then provide you with a financial update for the first quarter 2020 and an overview on our liquidity situation.

So let's get started. I'm on Page 3, the financial key figures for the first quarter of this year 2020. Many of you participated in the Capital Markets Day. And during the Capital Markets Day on March 3rd, we presented the long-term attractive growth trends of our industry. At that time, COVID-19 effects were predominantly limited to China. Despite the early China impact, we can, however, report today a solid start into the year as COVID-19 started to impact us in Europe and in North America from the middle of March onwards.

Our order intake in the first quarter reached €2.1 billion, down slightly by minus 1.8%, driven by lower volumes in our Industrial Trucks and Services segment, whereas SCS increased quite nicely. Our revenue stood at €2 billion, 2.7% below the previous year, and we achieved an adjusted EBIT of €144 million in the first 3 months of 2020, representing an adjusted EBIT margin of 7.1%. Free cash flow for the group came out at -€220 million, also driven heavily by the acquisition of DAI in early March.

Now as you're all aware, the current situation in Europe and in the US makes it impossible for us at this point in time to provide a reliable outlook for the performance of our business over the further course of the year. And we have therefore decided at the end of March to retract the outlook for 2020. And we will come up with a new outlook for the remainder of 2020 when we do have much better visibility.

Let's move to the next page, Page 4, some of our COVID-19 self-help measures. First of all, we are focused on protecting the safety of our employees and business partners, as it is our goal to make an active contribution to limiting and preventing a further spread of the coronavirus.

We have asked our employees to work remotely from home wherever it is possible and have aligned all processes and systems accordingly. We also started a broad information campaign, educating all stakeholders about COVID-19, security measures, social distancing rules, and so on.

Within our production, we have changed shift models to staggered work shifts. We have adopted all of the workplaces according to distancing rules. And additionally, we have provided protection equipment where needed. Besides protecting our workforce, we continue to serve our customers as best as possible. Since supply chains started to be disruptive, we are currently and continuously tracking our own supplier situation for material availability.

And moreover, in order to mitigate the disruption caused by temporary delivery problems from some of our suppliers, we have decided to suspend production in some of our key production

sites for Industrial Trucks and Services in general for 2 weeks, mainly over the quieter Easter period. We used this shutdown period to build up material buffers and have started with a safe and reliable production once again.

Our SCS plants are running. No major shutdown has impacted us there. However, at the end of the first quarter, so in March, we did see a number of SCS customer project sites with restricted access, which limited our physical service ability, and this had an effect also on both segments, where service people were not able to get to sites and of course to the installation work for automated systems in those cases.

Meanwhile, we achieved special permits from system-critical customers so that we could serve them, both at ITS and SCS, despite some of the restrictions. And we have also been able to get these permissions allocated to some key suppliers so that we could keep things moving. Furthermore, our Chinese factories are now running at pre-COVID-19 capacity levels again.

On the financial side, to further preserve our financial strength, we are tightly steering all of our expenses. This started very heavily in February and March. And we applied for short-time work wherever possible. We have postponed some of our strategic investments, like the expansion in CapEx for Poland and in China, by approximately 3 months initially.

We adjusted the dividend proposal to €0.04 per share, and we have inserted spend committees to limit our spending in all units around the world. Additionally, as a precautionary measure, we have entered into concrete talks with banks to explore the

opportunities for further loan commitments in order to strengthen our financial situation.

Taking a look now on Page 5, here, you can see all of our factories and see the factories that are currently in operation, both for ITS and SCS. So you see that most of the factories are now up and running. Only selected plants are closed for Pune in India, Indaiatuba in South America, are closed due to a government decree, which will last at least until the end of this week. And in Summerville, we have suspended production for 2 weeks.

So let me move now to the market update. On Page 7, we focus on industrial trucks, and it shows the global market development by region for the first quarter. In general, the industrial truck market development was already dampened -- we can't forget that -- before COVID-19 impacts affected the markets. And the COVID-19 impact was predominantly limited to Asia-Pacific. The first pandemic effects in Europe and North America started in March.

Western Europe saw a decline of minus 5.5% in Q1, mainly driven by major markets within the region. Eastern Europe decreased moderately by minus 3.5% in Q1, which was mainly driven by a decline in Poland. China saw a significant double-digit decline, with 21.1% in the first quarter due to COVID-19 shutdowns, which impacted all product categories within the region, including us. North America grew by 3.6% in Q1, still driven by a strong month of January. And South and Central America again turned negative in Q1, minus 8.5%, particularly driven by a high base in the prior year as well as the tense political and economic situation currently in the region.

So as a result of these regional developments, the global market declined by minus 9.4% in the first quarter of 2020 and is expected to further deteriorate in light of the prevailing reluctance to invest at least in the second quarter.

So let's move onto Page 8 and showing a breakdown of KION's performance and growth in these regions. KION declined by minus 11.1% in Western Europe and by minus 23.4% in Eastern Europe, stronger than the market, and this development in Europe was driven by three main points.

Number one, our exposure in certain industries that are significantly impacted by COVID-19, such as metals, logistics, and chemicals, so these industries where we have market shares, high market shares, are more heavily exposed to COVID-19 shutdowns.

Secondly, as we explained last year, which was an advantage and is an advantage in normal times and will come back, our customer base is comprised of a lot of small- and medium-sized customers, which are in particular right now burdened by the pandemic, Italy, Germany, and those markets.

Number three, we did have much lower additions into the short-term rental fleet as well as short-term rentals sold to our dealers, which are impacting our market development in Q1 negatively.

In China, our order intake declined by minus 19.8% in the first quarter but developed better than the market. In North America, KION declined by minus 23.4% in the first quarter 2020, in particular impacted by the closure of our Chinese plants, as you know, which are heavily exporting or importing in the US, so

exporting products from China to North America. South and Central America, KION's unit order intake decreased by minus 22.2% in Q1, driven by delayed key account deals as well as high FX-related pressure on imported products.

So overall, for KION, the negative trend of the pandemic is visible. And in the first weeks of April, we have seen this development continuing. We are convinced, however, that this weak performance is definitely not a blueprint for the full year and for the remaining year and that we will recover at least with respect to our market share. Clear is from this pandemic, month-to-month volatility and shipments and order intake with our suppliers will be significantly more volatile than it was in past years.

With that, I'd like to now hand it over to Anke with the financial update.

Anke Groth

Thanks, Gordon. And also, welcome from my side. Turning to Page 10, you will see the key financials for the first quarter 2020. Order intake stood at €2.1 billion, only slightly below the previous year level. And it was in particular supported by the strong SCS development.

Our order book of €3.6 billion at the end of March is stable compared to the end of December 2019. Revenues reached €2 billion, down by 2.7% in the first quarter of 2020, mainly impacted by the moderate decrease in our IT&S new business.

Adjusted EBIT came out at €144 million, resulting in an adjusted EBIT margin of 7.1%. This was in particular driven by lower volumes and higher costs. And as IT&S is the main driver, let me explain it more in detail on the IT&S side, which is coming next.

With respect to costs, a general remark. Please be aware that our initiated countermeasures against COVID-19, which Gordon has just described, will have an effect already visible in Q2, but of course, not yet in the first quarter of the year.

Net income decreased accordingly to €68 million, down by 27.2%, driven by our operating performance.

Let's move to the segments. Let me continue with the key financials for the segment Industrial Trucks and Services, which you can find on Page 11. Order intake fell by 7.7% to €1.4 billion in Q1 2020. The order book for the IT&S segment stood at €1.3 billion, down by roughly 6% in comparison to yearend.

Revenue decreased moderately by 4.4% in the first quarter to €1.4 billion, mainly driven by lower volumes in the business as a result of the overall market environment. However, the environment also has an impact on our service revenues, which decreased slightly at 2.4%.

Adjusted EBIT declined by 35% to €97 million in the first quarter 2020, resulting in a reduced adjusted EBIT margin of 6.7% compared to the previous year level. The main drivers for the margin development in Q1 2020 were the following.

We explained to you at the Capital Markets Day that, in order to secure the future of KION and to fulfill the Strategy 2027, we invest into strategic and focused projects. This means we had higher depreciation for our product launches, machinery, and R&D. We invested into IT projects. We have slightly higher R&D costs. And we still have ongoing project work for Poland and

China, despite the fact that we have postponed the projects, and therefore the CapEx slightly, but the project work in itself is still ongoing.

In addition to those investments into our future, again, which we explained in detail at the Capital Markets Day, we have supplier bottlenecks and inefficiencies in our factories. And of course, we had a full quarter COVID-19 impact in APAC.

Additionally, we are facing slightly higher personnel costs, which cannot be compensated by growth. So these are the reasons why IT&S has seen the decline in margin. And overall, in summary, IT&S was impacted top and bottom line by first COVID-19 effects.

If we move onto the segment Supply Chain Solutions, which you can see on Page 12, it's now also including DAI, as we closed the acquisition beginning of March.

The segment saw a significant increase in order intake, nearly 14% up, which further improved also the growth rate of the rolling average order intake to 12.3%. The development was supported by a good order intake from pure-play e-commerce and food and beverage verticals within the US and Europe. With this, the order book for the segment reached €2.3 billion at the end of March 2020, representing an increase of 4.2% versus yearend 2019.

Revenue increased by 2.2% to €581 million. As service revenues grew by 18%, in particular due to upgrades and modernization, business solutions declined slightly by 3%, caused by specific site delays on the request of the respective customers.

Adjusted EBIT increased significantly by 21.8% to €59 million and resulted in an improved margin of 10.1% compared to last year's 8.5%. Although the margin was impacted negatively by higher costs from SG&A and R&D, the margin was more than overcompensated by a positive effect from an improved operational performance in project execution, which continues the positive trend as of last year. And additionally, we saw a solid growth in customer service activities with good and healthy margins.

In summary, SCS saw a very good order momentum and business performance.

Page 13 shows the reconciliation from the adjusted EBITDA to the net income for the group. As mentioned before, adjusted EBIT fell by 21% during the first quarter of 2020. As a result, the reported EBIT decreased by 24.3%.

Lower earnings and the availability of some tax incentives led to a decline in taxes in the reporting period. And as a consequence, the effective tax rate decreased to 28.3% in the first 3 months in 2020, slightly down from 30.5% in the previous year quarter.

Overall, net income showed a decline of 27.2% in Q1 2020, and this equals an EPS of €0.58.

Details on free cash flow are shown on Page 14. Free cash flow during the first quarter came out at -€222 million, significantly below the prior year level. This was, among others, driven by our operating performance as well as by a change in net working capital of €122 million.

Both segments had very low trade payables in the first quarter of 2019 based on some phasing effects which did not repeat in the first quarter 2020.

We also had a higher tax payment due to higher earnings in 2019. And finally, the operating CapEx spending increased due to our production capacity expansion in Poland as well as a gross payment for the acquisition of DAI of €95 million, which significantly impacted our free cash flow development in the first quarter. As we also acquired some cash from DAI, the net outflow amounted to €86 million in the cash flow statement.

Let's move onto the net debt of our business on Page 15. At the end of March '20, net financial debt stood at €1.9 billion, an increase versus prior year level, mainly to fund the current working capital needs as well as the DAI acquisition at the beginning of March. Therefore, our leverage on net financial debt increased to 1.2x compared to yearend 2019.

The liabilities from short-term rental financing have decreased to €578 million, reflecting the development within our short-term rental fleet. And as a result, the leverage on industrial net operating debt at the end of March 2020 stood at 2.3x, slightly up from 2.0x at yearend 2019, and we expect that leverage on INOD will increase in the course of the year due to the coronavirus pandemic.

Finally, our net pension liabilities decreased nicely due to higher interest rates. And therefore, the leverage on industrial net debt increased only slightly to 3.1x.

Let's move onto Page 16, which shows KION's liquidity situation at the end of March. The KION Group continues to have an investment-grade credit rating from Fitch, who confirmed their long-term issuer rating of BBB- with a stable outlook, as well as a short-term F3 rating, both dated April 2020, so very recently. Besides that, Standard & Poor's classified KION with BB+ with a stable outlook since December 2019.

Looking at our liquidity and financing structure, we had roughly €220 million free cash and cash equivalents on our balance sheet at the end of March. Moreover, we can make use of a fully committed revolving credit facility of a total amount of €1.15 billion, of which €83 million were utilized as of 31st of March.

Where do we stand today on the 27, 28th of April? In the column 2020, you do see €302 million commercial papers. Commercial papers are a short-term liquidity instrument, and we couldn't prolong all of it in April. The liquidity was therefore replaced by drawings out of the revolving credit facility, and the utilization is now up to €370 million because the commercial papers were replaced by a drawing under the revolver.

If it comes to commercial paper, you should know that, in total, we have a commercial paper program which could provide us with liquidity up to €500 million, and we are working on the features of our program to make it eligible for a broader market community.

What you can also see is the debt in the full year 2020 is mainly caused by working capital movements and the respective drawings within the available debt instruments. The first upcoming term loan maturity will be due in late 2021.

The credit relations as well as our promissory notes are governed by a covenant which is based on the last 12 months' adjusted industrial EBITDA in comparison to the INOD. And we still have substantial headroom.

To save liquidity, the countermeasures Gordon touched upon are well underway. Nevertheless, based on the uncertainty of the length and consequences of the corona crisis, we are currently exploring further loan commitments to strengthen our financial situation.

And with this, I hand back to Gordon for some closing remarks.

Gordon Riske

Yes, thank you, Anke. Usually, at this point, we would've shown you the outlook for the full year 2020. But due to the current uncertainties, we will come up with a new outlook when we have better visibility.

In summary, the COVID-19 crisis will significantly impact our order intake revenue, which will in turn negatively affect the adjusted EBIT and cash flow. Having said that, maybe a couple of comments, three comments. Number one, in general, our long-term growth drivers and trends are still valid. Number two, the material handling industry is still today and will remain a very attractive market also after COVID-19.

And number three, we do expect to see even higher demand for automation, digitalization, and solutions around e-commerce globally. And matter of fact, at SCS, we are seeing some of that now. This is why we are continuing the investments that we

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outlined in our Capital Markets Day on March 3rd to move this company forward.

So looking onto Page 17, you see our financial calendar. The next event is the publication of our results for the second quarter. That'll be on July 30th, 2020. Furthermore, we have not yet decided on when we will carry out an AGM, but we will let you know as soon as possible after a decision has been taken.

And 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 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.

Sven Weier

Yes, thank you. It's Sven from UBS. Thanks for taking the questions. The first question is just on the EBIT development on the trucks side. Obviously, you mentioned those three effects, the volume, the strategic cost, and the supply chain issues/efficiency issues. Just in terms to get a better feeling for your real operating leverage in the business, is it fair to assume that each of these factors contributed roughly like a third of the absolute EBIT decline, or should we assume a totally different constitution of that? That's the first one.

Anke Groth

I would put it into a slightly different bucket than you did, Sven. First of all, hello from my side. If I look at the first, I would put it more into two buckets. The Capital Markets Day investments we touched upon a strategic and focused nature. That is for me the first bucket, and that is nearly half of the effect.

And the second bucket are the inefficiencies, the bottlenecks, APAC development, and the higher personnel costs which cannot be balanced out by the missing volume. And that is the other half of it.

Sven Weier — Okay. That makes sense.

Gordon Riske — One comment on that. That was €50 million is what you're talking about. If you take half of that, our strategic investments and so forth that we believe in because the market is changing, that ups the count by €25 million. That gets you up to -- from €144 million to €170 million, gets you into the over 8%, which would be kind of the expected, what markets perhaps expected to be. So that really needs to be put in the correct perspective, as you say.

Sven Weier — Yes, and I would guess the supply chain issues you had in Q1 should also at some stage hopefully normalize, maybe not in Q2, but I guess you're working on that one as well, right?

Gordon Riske — Well, don't forget we had the whole Q1 of China, right? That's a significant -- they were shut down for 2 months completely. So that was a big part of that other half.

Sven Weier — Yes, and the strategic cost is then -- we should expect that also similar portions then for the coming quarters, right? So it's -- or was it more frontend loaded?

Anke Groth — I would say, if it comes to depreciation, which is in there, that is, of course, not influenceable. And the Poland and China project work, that's a minor part, and that's also still, of course, ongoing because we believe in those projects. Even if we postpone them, we still have to work on those projects.

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What is part of our countermeasures is the investment into IT projects. So we have started to bring that down and also push that out for a couple of months, as well as the higher R&D spend we have talked about at the Capital Markets Day. So we are also more cautious with respect to R&D spending. So within the first buckets, there are two positions where we will see in Q2 a reduced spending, Sven.

Sven Weier

Okay. Thank you for that. And the other one would be just -- I know you typically don't give us trading updates, of course, within the quarter, but obviously, you gave us a great overview about what's happening on your production footprint side and how you have restarted. But I was just wondering, at the same time, in April, how demand has developed then further. Do you see a further significant deterioration against the exit rate you had at the end of March, or is it slowing more gradually? Maybe you could just give us just some feel for that, how that is developing.

Gordon Riske

Well, if I take it into the two buckets again, SCS looks pretty good I must say in terms of order intake, a big project pipeline, good project pipeline. We're enthusiastic about it. The one comment I made is, when it gets to the install side, being able to get to some of these sites, that can change from one day to the next, right? New York, you've got a site going on, and they say, "Well, you can't be there for 2 weeks." So that's a little bit tough to manage at the time, but order intake, SCS looks quite positive at the moment.

ITS, China has come back quite nicely in the first weeks of April. So I think that Europe is going to lag behind there in a couple of months. And right now in April, it's just too early to give a good

feel for that. That will be a little bit depressed, but China is a good sign that things are coming back also from a market point. But I think we all have to be realistic when markets go down by this amount in such a short time. Things will take a little bit to recover.

Sven Weier

But I guess you've been going out of the quarter end of March and in Europe already on quite a weak note. And I was just wondering if, in April, there was just another lag down, or is it kind of stabilizing at this end-of-March level, so to speak?

Gordon Riske

Too early to tell, but we hope it doesn't go down any further than the March, but it's too early to tell.

Sven Weier

Okay. Thank you, both.

Sebastian Growe

Yes, good afternoon. Thanks for taking my questions. Hi, Anke. Hi, Gordon. First one is also around ITS. And here, my question is to what extent you might be considering not only temporary cuts with the workforce, but also might be open to permanent adjustments.

In that regard, you also did show us the 23 production sites that you have overall at ITS. Yes, 13 or 14 of them are located in Europe. So it still looks a bit scattered, quite frankly. And with that, I would leave it up to you, whatever you want to provide as an answer to it.

And the second question I would have is on financing. Anke, you said that you expect that the leverage will further increase due to the corona situation. And you also say that there's still substantial headroom when it comes to the covenant. Again, for background, can you at least share with us what volume you're shooting for

when it comes to the extension of credit commitments? That would be my two questions. Thank you.

Gordon Riske

Yes, start with the first one. You know we have a quite, let's say, well-in-place short-time work system, not only in Germany, but in other European countries. And we will use that as extensively as we need to, and this does give us some flexibility.

We have in this last crisis -- 2009, we did close a lot of manufacturing plants in Europe and around the world and moved them to lower cost-based countries. So that does give us some more flexibility. And we've also broadened our revenue coverage into these regions.

And if I want to remind everyone, in 2018 and '19 and even parts of '17, we were barely able to keep up and working three shifts and so forth. So it was quite a strenuous time. Now it's just the opposite. This is true. So somewhere, there's a middle ground. And I think, as we do optimize our footprint, we have moved to lower, more flexible countries.

If we have to adjust our factory sites going forward, then we will do so, but right now, we are looking to use the short-time work and other flexibility clauses that we do have with the workforce to get through this period because, should it come back at levels of 2019, and who knows when, but those are high levels that we need to be able to deliver to also.

Anke Groth

Yes, I would also like to add to Gordon's answer. What we have seen in the financial crisis, when we also had a severe downturn in markets, then over the course of 1 to 2 years, the market came

back very rapidly. And therefore, also then of course, our workforce is needed.

With respect to financing, you asked for the volume we are shooting for. Nobody really knows at this point in time how long and how deep this crisis will be. So what we are currently exploring is - we are shooting for a volume which would leave us with nice flexibility and the possibility to act.

So I would tend to draw or put up an additional credit facility once so that we are covered throughout this crisis and don't have to do it, so to say, frequently. That is how much I can tell you at this point in time, Sebastian.

Sebastian Growe — Yes, and if I may ask that as a follow up just very briefly, when you acquired Dematic, obviously, there were very different leverage factors back in the days. You were open obviously to also have some fresh equity. Is that something which you would rule out at this point? Because I think there are a couple of talks in that respect in the market as we speak.

Anke Groth — I'm currently not preparing a capital increase. If you might know, we also don't have authorized capital. And as Gordon mentioned, we haven't put up a date for a new AGM. So currently, we are in talks with banks in order to have more headroom on that side.

Sebastian Growe — Sounds good. Thank you so much.

Akash Gupta — Yes, hi, good afternoon, everybody. My first question is on IT&S orders, if you can comment on share of orders that you financed and using your balance sheet with respect to the level we saw in 2019 and whether the change in market share or loss in market

share has to do anything related to financing equipment. So that's the question number one.

Gordon Riske

Let me start with the second one. No, as a market share, a couple of aspects to that. First of all, as I stated, in the customer base we have at -- we do serve, we're one of the few companies left in Europe that has a balanced portfolio of warehouse trucks and counterbalance trucks, heavy trucks, etc.

So right now, if you're only in warehouse, you will be less affected. That's true. But when markets come back, and they will come back, if you have a more broad product line, including counterbalance trucks, then -- and that was the same thing that happened 2009, then you do come back very, very strong, as general industry increases. So this ability of financing something with our balance sheet has absolutely no impact on market shares.

Anke Groth

And with respect to your other part of your question, so we don't see any limitations on the financing side of the leasing fleet. And also, the proportion of shares, so the roughly 50% we mention frequently, that hasn't really changed. But also, we do have refinancing. We have leasing lines. We still do our ABS programs and so on. So there is no limitation in getting financing for our leasing sales channel.

Akash Gupta

Thank you. And my second follow-up question is on financing. So you said in your prepared remarks that you have substantial headroom. But I think we are at 2.3x leverage, and you said it will increase in the course of the year. So just wondering, will you proactively reach out to your creditors to get some sort of

relaxation like we have seen some companies are getting due to COVID-19?

Anke Groth

You can imagine that, of course, liquidity is king in such a crisis. And therefore, we have put all the measures in place Gordon has spoken about. And we are in constant dialogues with our banks since the beginning of the crisis. We just spoke about leasing. So we're also in frequent contracts with the refinancing banks on the leasing side and also with our house banks and the core banks who are financing us with respect to secure our liquidity going forward.

And during those talks, of course, you touch on the debt covenants you are having and on projections going forward. So it's part of the overall discussions you frequently do have with your banks.

Akash Gupta

Thank you.

Martin Wilkie

Thank you. Good afternoon. Martin from Citi. So the question on working capital, obviously, quite an outflow in Q1. Ordinarily, you might expect to see a release of working capital in a downturn. You're pushing in from inventory. And you mentioned about payables in Q1. But just to give some sort of sense of how we might think of the working capital developing, particularly as sales will probably be a lot lower in Q2. So that's the first question.

Anke Groth

So yes, Q1, we gave the explanation with the lower payables in comparison to Q1 2019. But what you can also see is higher inventory. We have spoken about the supplier bottlenecks and the material buffer we needed in order to now ramp up the plants again. So of course, some of it is also something which you might

see in the working capital. And I would expect that going forward into Q2 as well, as we do have to secure the production going forward. That means that we are currently ramping up the inventory slightly.

And the second effect I would expect also for Q2, as we are in a crisis, I would expect our DSOs to go up slightly, and therefore increasing the working capital needs in Q2. That's I think normal behavior, a normal pattern you would expect and you see in a crisis.

Martin Wilkie Okay. So we shouldn't expect a big release of inventory or anything like that in Q2.

Anke Groth I'm so sorry. I wasn't able to understand your question.

Martin Wilkie Just in terms of whether -- in a downturn that you're able to effectively sell out of inventory and therefore see a working capital inflow from inventory release, that's not what we should expect in the second quarter. It's more about building buffers to secure supply chain and so forth.

Anke Groth Yes, it's a buffer to secure supply chain. So that's definitely the most important point. But secondly, what is also observable, and that is also something we learned in the last crisis maybe, but especially in this crisis, you know that some of our customers have shut down, for example. So we have some trucks, finished trucks in the inventory which we currently can't transport to our customers. And that is also something which is part of the whole inventory effect. So the majority is due to ramping up for our own production. But there is also an increase in finished trucks due to some problems on the customer side.

Martin Wilkie — Okay. Thanks. And if I can, my second question's just coming back to the covenant. You mentioned in the past the significant headroom. And obviously, your leverage has been up above more than 3x in the past. Can you tell us? What is the headroom? Is the covenant set at 4x, 5x, just to give us some sort of sense of how much headroom you have towards that covenant?

Anke Groth — I'm really sorry, but as I have received this question, of course, as you can imagine in the past, I myself looked again into our credit agreement, and we have a confidentiality clause in our contract. So I can't give you an answer to that question. I'm really sorry, but I really hope you understand.

Martin Wilkie — Okay. No, no problem. Thank you very much.

Felicitas von Bismarck — Yes, thank you very much. I have one follow-up question to Martin's. I'm a little bit surprised about the working capital because, when you look at 2009 or any other downturn, you would have a strong release in working capital. I understand the supplier problems and the ramp up and these things. But do you think your absolute working capital is going to come down over the year, or is it just going to be at these kind of levels? Especially Q2, you saw last year a huge ramp up in working capital. How would that compare?

Anke Groth — So what I would expect for Q2, as I just described it, Felicitas, I would still expect an increase in working capital based on the inventory, the material buffer, and also the DSOs. But during the course of the year, until the end of the year, I would expect that to go down slightly again and starting to normalize.

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Felicitas von Bismarck	Okay. But if I understand you correctly, the shift in payables, that was already in your guidance when you gave that pre-COVID, right, in your cash flow guidance, the payables part.
Anke Groth	Yes, yes.
Felicitas von Bismarck	Yes, okay. Good. The second question I had was also a follow up on your comments. The underperformance in Western Europe, I'm sorry I have to come back to that. You mentioned that part of that was rental investments that you declined, so decreased the rental fleet again. Do you think that's going to reverse in a couple of quarters, or do you think this pattern of underperformance is going to be in that extent that it is right now?
Gordon Riske	Well, of course, it's going to turn around as the year goes. The same team that has outperformed the market in several years, especially in the last year, to significantly higher profit margins than anyone in the industry is still there, I'm happy to report. And yes, we were cautious certainly on the short-term rental. Perhaps other companies also view that a bit differently or have March as a yearend number. And some competitors have March as like our December, all kinds of things happening. So I do expect, as the year moves out, that we will regain some of this lost territory in that the first quarter is no absolute indication of a full year.
Felicitas von Bismarck	Okay. Thank you very much. Very clear. And one just -- because I didn't understand acoustically, you mentioned the commercial papers. Did you say you weren't able to place more, but you wanted to place more? I didn't understand that.

Anke Groth

No, sorry, Felicitas. I tried to explain at least, first of all, we have a total volume of commercial papers which we could place of €500 million. So that's the total volume which we have. Then you see on the chart that, until March, we had placed €302 million. But in April, some of these commercial papers couldn't be prolonged. So we had to take that money out of the revolving credit facility.

Felicitas von Bismarck

Okay. And why couldn't it be prolonged?

Anke Groth

Well, because the market is getting more and more difficult for commercial papers, especially here in Germany. What we are now doing, we are preparing or we have prepared the Fitch short-term rating in order to have a rating for our commercial paper program as well. And we are currently striving to get a label which is so called a step label so that we might be eligible also under European programs, like an EZB program, in order to get access to the commercial paper market again.

Felicitas von Bismarck

Okay. Thank you very much. Very clear.

Philippe Lorrain

Yes, good afternoon. Thanks for taking my questions. So I've got like one on the SCS margin profile. What would be the impact from a lower utilization point than if we assume that you've got some project execution, especially when it comes to the Americas? Because I guess Americas is still a significant part of revenues. And there should be like less flexibility on the personnel cost side, especially compared to Europe. So what could be the impact on that segment?

And also with a direct relation to that as well, in terms of how we should think about the revenue profile across the coming

quarters, would that be possible for SCS to reach, say, €800 million of revenue in a separate quarter, or it is something that you can't really achieve due to capacity limitations?

Anke Groth

Philippe, hi. With respect to project execution at SCS, what we have seen in the first quarter already for SCS is some, I would say, problems in project execution with respect to customer sites. So there are a couple of sites which were locked down, especially also in America. I commented on Q1, where we had sites where customers postponed projects, but the matter of site closures on the side of our customers, that started in April.

With respect to the engineering activity, we do some of the activities also remotely. So not everything has to be done onsite. But if it comes to implementation of a project, that of course needs to be done onsite. And I expect that we see some impact of the site closures also especially in North America during the second quarter.

Our people, if we can -- Gordon has described it -- if we can go and apply for short-time work, we do it wherever we can and wherever it's possible. But if you look at our order intake at the SCS side, and also, our pipeline is still very well filled, and project engineers are a very rare species out in the market. We rather would tend to treat them very good in order to keep them and in order to be ready once we can implement and work on our projects again.

Philippe Lorrain

Okay. That's a great remark. So I guess that it's fair to assume that, for a certain shortfall in revenue, if we take SCS versus ITS, probably the margin at SCS might be reacting a bit more strangely, especially in the coming quarter due to these effects

from, let's say, lower utilization and the fact that you don't want to cut into the workforce.

Anke Groth

I would say it could be, but we are now end of April, and we still have 2 months to go in the quarter.

Philippe Lorrain

Yes, I appreciate that. And perhaps just like in terms of the technical limitations part to reach certain level of revenues on a quarterly basis in SCS, because you've got like, of course, the utilization of the engineers, the project engineers, the execution workforce, and so on and so forth. So is there a possibility, let's say, to pick up really massively in revenue over the course of the remainder of the year and reach at some point perhaps like a mark of €700 million, €800 million in a specific quarter in terms of revenue? Is that something possible, or is there a limitation?

Gordon Riske

Good. As Anke said, right now, it's pretty difficult to predict the exact revenue for Q3. But let's look at limiting factors. First of all, can we produce the things that we need? And our factories in the Czech Republic are fully running. Our factories in North America and in Mexico are fully running. And our distribution center, where our own things are, is in good shape.

On the engineering side, that's the solutions development. I think for the year 2020 - we pretty much have that under control. So the only true limiting factor is, can we get enough project and startup engineers on the customer sites in a continuous form? It doesn't do you any good to be there 3 days when actually you need to be there 3 weeks. So that is certainly a limiting factor, and I wouldn't want to connect it now with a euro number. We are doing everything we can to ramp up and keep our personnel in

place. And quite frankly, I'm quite confident in the ability of SCS for this year to come through this in pretty good shape.

Anke Groth

But, Philippe, we haven't seen €800 million in the past. So if you look at the past development of SCS, €800 million is quite a stretch for the business. I wouldn't rule it out. SCS is having a very good development, but it always depends on the specific projects, as we explain frequently, the milestones you are reaching in a quarter, and so on. So €800 million is quite a substantial amount which we haven't reached in the past.

Philippe Lorrain

Okay. Thanks. And the last question was basically on the two segments. Would you share with us perhaps any indication on the sales level that you need in order to be breakeven at EBIT contribution?

Anke Groth

Philippe, quite frankly, I'm getting a lot of questions with breakeven or the theoretical question, when you don't make any revenues in a month, what does it do to your EBIT development, the breakdown of costs, the variability of costs. And I really do understand how important those questions are to maybe get a feeling of the development.

But this business is comprised of ITS, of the new truck business. We have a significant service proportion. We do have the leasing business, where we have steady inflows, which are not depending really on new trucks, bringing those into the market, or the projects we are implementing at the SCS side. So there are a lot of factors influencing the answer, and it's really difficult to give a very generic answer here.

Philippe Lorrain

I understand. Okay. Thanks.

Katie Self

Hi, good afternoon. I've just got two questions. And actually, maybe one follows on from what you were just saying, Anke, around the service business within ITS. I wonder if you can give us a bit of a breakdown of how the performance has been within that. What have you seen sort of aftersales versus the utilization rates in short-term rentals, used trucks, just a bit of color on those different pieces?

And then my second question would be more around China, and this is probably more qualitative because you won't have the data on it yet. But with the recovery or the pickup in China that you've seen later in the quarter, I'd be interested in your view on, how much of that is a kind of catchup effect coming out of the lockdown period, and how much of that is a genuine recovery of demand or of production back to pre-COVID-19 levels, particularly given, obviously, China is going to be losing access to many of its export markets at the moment? Just be interested to hear your view.

Gordon Riske

Yes, maybe on the second question, I look at March alone. That was certainly from the factory and getting things done and moving primarily catchup, so order backlog finally being delivered to customers. And from a market standpoint, if I look at so far -- and April is not done yet. I know there's only a couple more days. It seems to be still pretty good.

How much of that is then the feeling of people, "Okay. I'm free, and I want to go buy something," and which means you trigger an event at some kind of warehouse, and you buy forklifts and so forth. So this whole pent-up demand part, that we're going to have to wait and see because you're absolutely right. If some of your

export markets are also curtailing demand, it will have a longer-term effect.

All I can say is March was primarily catching up. And April, we see good order activity, project pipeline. That's also interesting as the number of conversations going on with customers. Fully independent of where we are in the world, that is still very relevant. Also, in Europe, a number of projects being discussed, customer questions, project planning. It's not like everybody's kind of cocooning and not doing anything. That has not happened. It's not person to person anymore. A lot of that in Europe is via telephone conferences. But that part is still quite robust if I look at all the potential products. So that is encouraging.

Anke Groth

Hi, Katie. With respect to your first question, the service business, as we said in revenue terms, it was slightly down by 2.4% in the first quarter in comparison to last year. And that was mainly driven by what we call aftersales. So that's ad hoc service, maintenance, and spare parts sales. And this is driven by, of course, a lower activity at customer sites as well as closure of some of the sites. So we do see here a slowdown of the business activities.

The rental business was still very well intact and stable, even if within the rental businesses, short-term rental showed a very slight decline. And I personally would have expected that to be more pronounced already in Q1. But there was a nice balancing with events and trade fairs, of course, having been canceled nearly throughout the world, but food and beverage, for example, picking up again or picking up dramatically. So there, we only have a slight impact.

And if we look at the used business within the service section, that also was pretty stable in terms of revenues. So the decline really came from the aftersales section.

Katie Self

That's great. Thank you very much.

Richard Schramm

Yes, good afternoon. So just, yes, my question was nearly answered on this rental fleet you just mentioned. But could you give us, please, a kind of precise number? Because I think you mentioned that you have scaled back your fleet, which obviously then contributed to a stable utilization rate here. So how much of this minus 14% in Q1 of your volume has been attributable to this scaling back of your rental fleet, please? That's my first question.

Anke Groth

So there wouldn't be a drop through the 14% you have seen. The drop would only be roughly 12% if we would have invested into short-term rental as we did it in the last year's timeframe.

Richard Schramm

Okay. Thank you. And a second point, I think you mentioned that this underperformance in Q1 was also attributable to your strong exposure and small- and medium-sized customers. Isn't that a specific risk in the current period that this customer group might also see some serious risk of insolvency and that there might be, at the end of the day, not enough potential for a sound recovery here, but that there might be long-term damage to this customer base? How's your experience from the past in this respect? Thank you.

Gordon Riske

It's still a little bit early to tell. You know governments around the world are spending a lot of money, which at some day will have to be paid back, but a lot of money trying to maintain productive employment because it has knock-on jobs which have significant

impact. This is the same for Northern Italy as it is for large parts of Germany, Poland, etc.

So I do think everyone will make an exerted effort to keep these small companies alive. But certainly, that is somewhat of a risk. On the other hand, small companies do have a tendency, once things are over, they come back very quickly because they're able to react very quickly. They're just more conservative. So they watch the money when times get tough.

So I wouldn't say that is a general thing that, for our longer-term ITS business, that that is a negative thing. It's actually a positive thing because those have been traditionally customers that do allow for higher margins, longer association with a particular brand, so brand loyalty, a much different case. And therefore, services and everything that is associated with this is a much longer-term relationship.

Richard Schramm

Thank you very much.

Operator

Thank you for all your questions. We apologize. In the interest of time, we have to stop the Q&A session. I would like to hand back to Mr Gordon Riske for any closing comments. Please go ahead.

Gordon Riske

Yes, thank you all, for participating in this first quarter call. It's a rough time in the markets, but we do believe we are on the right way. We have taken many measures to move the company in the right direction. Our long-term strategy, the market attractiveness is 100% in place. And we will hear each other again at the upcoming next quarterly report.