KION GROUP AG

Q3 2020 Update Call

Conference Call Transcript

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Anke Groth (CFO)

Gordon Riske

Yes, thank you, and welcome, everyone, to our update call for the third quarter of 2020. As a basis for this call, we'd like to use our Q3 2020 presentation. It's available, as always, on kiongroup.com under Investor Relations in the Publications section.

We will be presenting 4 parts during today's call and will then open up the call for the discussions and your questions. I will begin with our financial key figures for the first 9 months of 2020, and then we'll show you a selection of strategic highlights from Q3 2020, and this will be followed by a market update.

Anke Groth will then provide you with a financial update for Q3 as well as the first 9 months of 2020 and give you an overview of the current liquidity situation. We will then close the call with our updated outlook for the full year 2020.

So let's get started on Page 3 with our financial key figures for the first 9 months of 2020. With the support of our less cyclical SCS business and first signs of recovery in the ITS segment, we were able to improve our main KPIs since the beginning of the pandemic.

After a challenging second quarter for our ITS segment, we were able to increase our order intake by plus 2.8% in the first 9 months, so that the group achieved €6.7 billion order intake.

Our revenue stood at €6 billion, minus 8% below the period ending September 2019, and we reached an adjusted EBIT of €364 million in the first 9 months, representing an adjusted EBIT margin of 6.1%.

Our free cash flow for the group came out at a positive €105 million in Q3 2020, resulting in a free cash flow of minus €114 million after the first 9 months of 2020.

Overall, aside from order intake, our key performance indicators were, however, below prior year, but improving sequentially from the trough of Q2 2020. I think the most important thing about this challenging year 2020 is that we have continued building up our capabilities to be more competitive and innovative.

COVID-19 has been an accelerator in this regard, and that’s why we’d like to show you on Page 4 some of the specific examples of our strategic highlights in the third quarter of 2020.

We recently agreed to a strategic partnership with Quicktron, a Shanghai-based manufacturer of autonomous mobile robots, AMRs, using technology based on artificial intelligence. The collaboration is expected to expand our global product offering of automated warehouse solutions and is planned to include developments, common developments, joint developments, in this area.

Quicktron products will be distributed via the global sales and service networks of our brands Linde Material Handling, STILL, and Dematic. Moreover, we intent to strengthen this partnership with a minority stake, so below 10%, and we expect to be closing the transaction before the end of the year 2020.

Furthermore, we made progress in our manufacturing footprint expansion. With the groundbreaking ceremony of our new plant for the production of counterbalance trucks in Jinan, China, in

August, we took an important additional step in implementing our comprehensive China growth strategy.

According to the World Industrial Truck Statistics, WITS, China is the largest single-country market for new industrial trucks by units ordered in 2019 and has shown significant growth, which we expect to continue.

Moreover, we want to take advantage of the increasing electrification of industrial trucks and aim to participate in the expected growth within the value segment not only in China. Therefore, the industrial trucks manufactured in the new plant are also to be exported to other countries.

The project, with an estimated investment of approximately €100 million, aims to extent our product portfolio for industrial trucks in this important material handling market. The new plant is due to come onstream in 2022.

Additionally, we added a third factory building for Dematic at our site in Stříbro in the Czech Republic in response to the growing trend for omnichannel solutions and the sustained boom in e-commerce. The new building is expected to be used for the manufacture of conveyor belts, pouch sorting systems, as well as multishuttle systems.

Last but not least, we have established a euro medium-term note program with a volume of up to €3 billion, under which we successfully placed a corporate bond of €500 million at the end of September. The offering was oversubscribed by more than 5x. By issuing this bond, KION adds another element to its broad-based funding structure to strengthen the group's resilience and to improve its flexibility in challenging times. The proceeds of the bond offering shall be used for refinancing purposes and the improvement of our maturity profile.

So with that, let me move on to the market update. On Page 6, you see the industrial trucks and shows the global market development by region in the third quarter. Within the ITS market, all regions improved sequentially from Q2 until the end of September, predominantly as a result of the easing of COVID-19-related restrictions.

Western Europe saw only a small decline of minus 0.5% in the past quarter, driven by a recovery in France and Italy, whereas Germany has not yet reached pre-crisis levels yet.

Eastern Europe was able to return to its growth path with an increase of plus 7.7% year-on-year, driven by both Russia and Poland.

North America, on the other hand, started to recover as well, but was slightly negative with minus 1.1% compared to prior year.

South and Central America showed a strong rebound in Q3, increasing by plus 25.4%, which was driven by pent-up demand after the lockdowns in Q2.

The Chinese market recovered already in Q2 but was able to show an even stronger growth rate of plus 76% in Q3 of 2020. This development was significantly driven by warehouse trucks and IC trucks and, to a lesser extent, by electric trucks.

As a result of these regional developments and especially the performance of China with a market share of around 31% of the global market in the full year 2019, the global market increased by plus 24.1% in the third quarter of 2020. And so the global market for industrial trucks increased by 2.9% during the first 9 months of this year.

Page 7 shows a breakdown now of KION's performance by region. Although the past couple of months of order intake in units was above the last year, which is a good trend, in Q3, KION's unit order intake performance in EMEA could not follow the market development.

The main driver for this was in particular an increasing competition from Chinese players, which were strongly active in the area of entry-level warehouse equipment as well as low-cost IC trucks.

Moreover, we do have a lower exposure to industries which are a bit more resilient in this current COVID-19 health crisis. In addition, we may have suffered from customers that operate in more cyclical industries, such as automotive and related heavy industrial equipment. As a result, KION's unit order intake declined by minus 9.8% in Western Europe and by minus 9.6% in Eastern Europe in Q3.

Looking at China, KION's unit order intake significantly increased by plus 46% in Q3. However, we were lagging behind the even stronger market development, which was in particular driven by entry-level warehouse equipment as well as IC trucks, where we only have a smaller market share.

In North America, KION declined by minus 4.4% in Q3, which was partly driven by a high base in the prior year, including, as you know, the Menards deal.

In South and Central America, on the other hand, KION's unit order intake increased by plus 38.3% in Q3, driven by the outperformance across all product categories.

In total, KION's unit order intake showed a slight increase of 0.2% year-on-year in the third quarter of 2020 and therefore declined by minus 12.8% within the first 9 months of this year.

For Supply Chain Solutions, we continue to see good growth prospects in the market, which may have been accelerated due to the COVID-19 pandemic.

And with this, I'd like to hand it over to Anke, who will present the financial update.

Anke Groth

Thanks, Gordon, and also a warm welcome from my side. Turning to Page 10, you will see the key financials for the segment Industrial Trucks and Services for Q3 and the first 9 months of 2020.

The ongoing pandemic and the slowdown of the economy eased through the summer but was still a burden to our ITS segment. Looking at the third quarter 2020, our order intake fell to €1.4 billion, a decline of 4.8%, which was solely driven by the development within our new business.

At the end of September, the order book for the ITS segment stood at €1.3 billion, basically unchanged versus the level at the end of June 2020, but showing a decline of around 9% versus year-end 2019.

Revenue fell by 9.6% to €1.4 billion in Q3, mainly impacted by our new business, which declined by 18% in the past quarter. Our service business, on the other hand, recovered during Q3, which was supported by our long-term rental and used truck business.

Looking at the operating performance, we were able to generate an adjusted EBIT of €93 million in Q3, resulting in an adjusted EBIT margin of 6.6%.

Let me highlight the most important aspects driving the development of our adjusted EBIT. We are still seeing lower volumes and, consequently, a lower fixed cost coverage in our factories. In addition, as expected, we had further expenses of roughly €18 million in total for our strategic projects, as well as higher depreciation due to the recent product launches and investments into new machinery.

To remind you, included in our strategic projects are our expansion abroad, i.e. the new plants in China and Poland, increased R&D costs due to a lower capitalization rate, IT costs, as well as additional costs for setting up our lithium ion battery joint venture.

Against those cost increases, our temporary cost saving measures had a positive effect of approximately €36 million within ITS in the past quarter.

Moreover, adjustments in our variable employee remuneration for the current year led to a relief in bonus provisions in Q3, with a positive effect of €9 million. This won't repeat again in Q4.

What does this mean for the period January to September 2020? So the order intake in ITS fell to €4.1 billion, down by 10.9% year-over-year. The revenue during the first 9 months fell by 12.6% to €4.1 billion, whereas the adjusted EBIT declined to €205 million, resulting in an adjusted EBIT margin of 5%.

For Q4, we might continue to see the lower fixed cost coverage, a continuation, of course, of our strategic projects. We will also continue with cost saving effects, but lower than I just spoke about in Q3, and again, the positive one-off with respect to bonus is not repeatable.

Also based on the development in recent months, we have initiated a capacity and structural program mainly within our ITS segment. This program aims to streamline and optimize our organizational structures and capacity in our production, sales, and service, particularly in Europe, to reflect the expected medium-term market environment post-COVID-19.

The resulting expenses will be shown as NRIs. And in Q3, you can already see an amount of roughly €12 million until the end of September 2020.

In summary, the ITS segment is still feeling the impact from the COVID-19 pandemic, but the effects are clearly less visible than in Q2.

If we move on to Page 10, where you see the summary of the key financials for the segment Supply Chain Solutions. The order intake increased by 5.8% to €888 million in Q3, up from an already very solid level in the past year.

The very good development in the third quarter was driven by a strong demand in North America as well as parts of Europe, especially from pure play e-commerce customers, as well as from the grocery and the general merchandize vertical.

With this, the order book for the segment reached €2.9 billion at the end of September 2020, representing an increase of roughly 29% versus year-end 2019 and an increase of 6% compared to the end of June.

Revenue saw an increase of 10.6% to €664 million in the past quarter, gaining momentum post the COVID-19-related lockdowns and restrictions at some project sites, as well as benefiting from the recent order intake development.

Business solutions revenues grew by around 12%, whereas customer service revenues grew with a rate of around 6% in Q3, mainly driven by modernization and upgrades.

With respect to our profitability, adjusted EBIT in Q3 improved by 11.6% to €72 million, equal to a margin of 10.8%, driven by the volume-related growth and thus reached a similarly high level as in Q3 2019.

Looking at the period January to September 2020, the order intake increased by a very strong rate of 35.1% to €2.6 billion. Revenue impacted by COVID-19-related restrictions, which we have seen mainly in Q2, increased only slightly by 3.8% to €1.9 billion.

Adjusted EBIT amounted to €184 million during the first 9 months of 2020, resulting in a slightly increased margin of 9.8% compared to the previous year.

Overall, SCS again showed a strong order intake development in the past quarter against a high base, as well as a very solid project execution, despite a still challenging environment, and is now expected to continuously gain momentum in executing the order book.

Page 11 summarizes the key financials for the group. KION saw an order intake of €2.3 billion in Q3 2020, only slightly down versus prior year, and obviously strongly benefited from the Supply Chain Solutions business.

With this, the total order book grew to €4.1 billion at the end of September 2020, representing an increase of 14.1% versus year-end 2019.

Revenues declined by 4% to €2.1 billion in Q3 2020, which was entirely driven by the ITS segment. Due to the already explained performance of ITS, the adjusted EBIT for the group fell by 26.7% to €159 million in the third quarter and reached a margin of 7.7%.

Looking at the results for the first 9 months, KION saw a solid increase in order intake of 2.8% to €6.7 billion. Revenues declined by 8% to €6 billion in the 9-month period, and the adjusted EBIT fell by 41.8% to €364 million, which equals a margin of 6.1%.

So in summary, the ITS segment was still burdened by the market downturn and investment decisions of our customers, whereas SCS showed a more resilient profile, withstanding COVID-19.

Page 12 shows the reconciliation from the adjusted EBITDA to the net income for the group. As mentioned before, adjusted EBIT stood at €159 million in Q3 2020. Non-recurring items increased only slightly to minus €2 million. Thus, the reported EBIT decreased from €195 million to €135 million during the third quarter of 2020.

In addition, net financial expenses in Q3 are with minus €70 million, clearly below prior year, due to improved financing as well as reduced interest expenses from our leasing business and pensions. Overall, Q3 net income was clearly positive again with €82 million.

Looking at the first 9 months of 2020, adjusted EBIT came in at €364 million and reported EBIT at €273 million. The effective tax rate in the first 9 months currently stands at 36.6%. For the full year 2020, we expect an effective tax rate on EBT of between 35% and 45%.

Overall, net income declined to €132 million in the 9-month period, which represents an EPS of €1.18.

Details of free cash flow are shown on Page 13. In the third quarter, we were able to generate a positive free cash flow of €105 million. Therefore, free cash flow in the first 9 months of 2020 amounted to minus €114 million. Main reasons for the still negative cash flow were, in particular, of course, our weaker operating performance and therefore EBITDA.

The change of net working capital of minus €277 million burdened our cash flow, which was mainly due to the increase in inventories in connection with a temporary build-up to prevent supply shortages together with a net increase in contract assets and liabilities related to our project implementation.

Moreover, higher tax payments due to higher earnings in 2019 had also a negative impact. The net outflow for our rental business increased, despite the downsizing of our fleet due to the related liability repayment from financing, which overcompensates the change in assets. Finally, the cash flow from investing activities increased mainly due to the acquisition of DAI.

For the fourth quarter of 2020, we expect an additional cash out for the acquisition of the minority stake, which was mentioned by Gordon at the beginning, in Quicktron. And overall for delivering the guidance, a good level of free cash flow is expected to come in.

Page 14 shows the net debt of our business. As at the September 2020, net financial debts increased to €1.9 billion versus year-end, mainly to fund the current working capital needs as well as the DAI acquisition.

Considering our operating performance in the reporting period, our leverage on net financial debt only increased to 1.3x compared to year-end 2019, where it stood at 1.0x and benefited from our cost and liquidity management during the past months.

The liabilities from short-term rental financing have decreased to €524 million, which reflects the development within our short-term rental fleet. As a result, the leverage on industrial net operating debt at the end of September 2020 stood at 2.7x, up from 2.0x at year-end 2019.

Finally, our net pension liabilities increased slightly again due to lower interest rates. Therefore, the leverage on industrial net debt increased to 3.9x.

Page 15 shows KION's current liquidity situation at the end of September 2020. Our corporate credit ratings by Fitch as well as Standard & Poor's have been confirmed just recently.

At the end of September, our financial headroom amounted to €2.6 billion, consisting of a cash position of €425 million and undrawn credit lines of €2.15 billion.

During the last quarter, we created a euro medium-term note program with listing in Luxembourg, which allows us to issue bonds with a total volume of up to €3 billion. At the end of September, we used that program for an initial placement of a €500 million bond with a 5-year maturity. As Gordon already mentioned, the issuance was more than 5x oversubscribed, ending up with an annual coupon of 1.625%.

The bond proceeds are intended to refinance €654 million promissory notes originally due in May 2022 at the end of October 2020, thus improving our maturity profile. Overall, KION has a very solid liquidity profile and a broad-based funding mix available.

And with this, I hand back to Gordon for the outlook for full year 2020.

Gordon Riske

Thank you, Anke. Let's move onto Page 17 for our updated outlook. So you all know, 1 week ago, we published our updated outlook, including quantitative guidance ranges. And let me describe our thoughts around this outlook.

Now the current decline in global economic output is expected to continue depressing the market for Industrial Trucks and Services for the remainder of the year. Looking at the year as a whole, China is the only region predicted to see market growth, whereas the market will contract in the rest of the world, including in the EMEA region.

Despite the adverse effects of the COVID-19 pandemic, the market for Supply Chain Solutions is likely to grow as a result of the sustained uptrend in e-commerce.

Assuming a stabilization of the industry-specific conditions for Industrial Trucks and Services segment, we now expect for the group an order intake to be between €8.9 billion and €9.6 billion. The target figure for consolidation revenue is in the range of €7.85 billion to €8.45 billion, and the target range for adjusted EBIT is €465 million to €545 million.

Free cash flow is expected to be in the range between €50 million and €150 million, and the target figure for ROCE is in the range of 5.2% to 6.2%.

For the Industrial Trucks and Services segment, order intake is expected to be between €5.5 billion and €5.8 billion. The target figure for revenue is in the range of €5.45 billion and €5.75 billion, and the target range for adjusted EBIT between €265 million and €305 million.

For the Supply Chain Solutions segment, order intake is expected to be €3.4 billion to €3.8 billion, and the target figure for revenue in the range of €2.4 billion to €2.7 billion, with the target range of adjusted EBIT between €235 million and €275 million.

However, in view of the risks arising from the further course of the coronavirus pandemic, our assessment on the group's performance over the remainder of the year is still uncertain, and we see how this situation changes daily.

Further economic downturn in key sales markets would lead to KION Group's performance and financial results to differ significantly from those in the outlook.

So let's go to Page 18, our financial calendar. The next event is the publication of our full year results on the 2nd of March 2021. Until then, we look forward to meet with you at least virtually, and I hope sometime personally, at conferences and roadshows.

And with this, we'd like to close the formal part of this update call and hand it back over 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.

Martin Wilkie | Yes, thanks, good morning. It's Martin from Citi. Just the first question, we can obviously infer what you're thinking about the fourth quarter, given your range of guidance. Obviously, you know October is pretty much done now.

In terms of what gets you to the upper and lower end of the order ranges and I appreciate, in Supply Chain Solutions, it is lumpy, and therefore, there can be some uncertainty around that. But when you're looking in the truck business, in terms of what you've seen in October so far, how should we think about - what would drive the upper and lower end of those ranges in terms of your guidance for orders in ITS? Thanks.

Gordon Riske | Well, it's simply uncertain. We do have the production, all of our plants are working. I'm very happy with that, and all of our employees are safe. And as you saw with the backlog, we have orders to get there. However, we have factories in France. We have factories in the Czech Republic and in Germany. And with the actions taken also by the German government yesterday, there is just a higher degree of uncertainty, and so that's why we do have a broader range. And the uncertainty has perhaps even increased rather than gone away when we made the preparation for this call.

Anke Groth | And if I may add, Martin, especially what is important for also the results coming in is the revenue development and our service segment. So our ability to perform services to sell spare parts and so on is also very important for defining the guidance ranges or also coming to the upper end of the guidance.

Martin Wilkie | Okay. Thanks. If I can throw out a second question on the order conversion in Supply Chain Solutions, obviously another strong order intake quarter, and the guidance on the year suggests that that continues.

In terms of how long it takes to convert, you've given that not all customers are necessarily able to implement projects as soon as they might, but obviously, looking at that against what is - you're getting a stronger and stronger backlog volume, is the implementation time, is that backlog stretching out further? Is it now sort of more than 12 or 18 months, or how should we think about the conversion time for the increasing backlog in Supply Chain Solutions?

Gordon Riske

No big changes. As Anke said, the biggest variable is certainly, can we get to the sites? Can the customers have the sites open? Can our service technicians get out there? I think, from a backlog standpoint, yes, it's bigger, but don't forget, as I said in one of the first comments, we've also increased our footprint in Europe. We've increased our footprint in North America. So we do have the capacity to get the stuff out the door.

Martin Wilkie

Great. Okay. Thank you very much.

Sven Weier

Yes, good afternoon. Thanks for taking my questions. The first one is on trucks. The second one is on SCS. So the truck question is slightly twofold. On the first part would be - I was curious if you could frame the restructuring effort that you are going to do there in terms of the savings you expect out of it. So are we talking bigger numbers here? And is the ultimate aim of this exercise to reach the previous margins of the truck unit also without the revenues reaching the previous levels, given that you have some structural concerns there as a result of corona?

Anke Groth	Yes, hi, Sven, first of all, from my side. The program is a program tackling ITS, especially in Europe, as we have said. And in Europe, nearly all countries where we are acting in, it's an effort of right sizing, and it's tackling production as well as sales and service. And you already see some NRIs in UK and some of the smaller European countries. But in those countries, especially in Germany, where we have workers' councils, Mitbestimmung, we have to negotiate and come to terms here. But therefore, we expect hopefully to conclude those negotiations until year-end, which would then also result in higher NRIs up until year-end. With respect to the savings, the saving range, we see that and estimate that currently in a range of high double-digit to low three-digit million per year, with an implementation time of up to 2 years. But again, that all strongly depends on the outcome of the negotiations with workers' councils, and the amount of NRIs will be in the same ballpark, slightly lower.
Sven Weier	But relating to my question regarding what is this all ending up in, is the ultimate aim of you guys to get back to the previous margin level without the revenues being at the same level, or is it just replacing now the temporary savings that you had this year that will go away eventually?
Anke Groth	Sven, we spoke about our margin achievement in Q3 and that the margin is suffering from a decrease in volume. We have temporary saving measures. Yes, some of those will be replaced by the savings we are going to achieve by this program. And the savings are sustainable. So these are savings which we not only see for 1 year, but also for the years thereafter.

Sven Weier

Okay. So I would guess, once you've concluded on these measures, you could give us a more detailed update in terms of, maybe more concrete margin goals then for the truck side, or should we for the moment assume that your old goal of 10% to 12% remains valid as a general guideline here?

Anke Groth

As we have said, our midterm targets are currently under review due to the COVID-19 situation, and we will give an updated guidance for the year 2021 in March, as normal. And this will then also include the outcome of the negotiations here.

Sven Weier

Okay. Thanks for that. And then maybe changing subjects to SCS, and here, I was wondering - obviously, you had a great year there in terms of order intake. Q4 looks promising. I don't know if your pipeline discussions already at this stage stretch into next year. And obviously, after such a strong year like this, does it look like a consolidation at a high level, or what's the early indication there? And I was also wondering if you could speak about your Tesco microfulfillment project more specifically and how you see that momentum growing. Thank you.

Gordon Riske

Yes, the outlook, order pipeline is properly filled. The e-commerce business is taking off all over the world, as you know. So we feel that the original premise when we bought it in 2016 and we said an average growth rate of at least 10% per year, that's still being confirmed, and we feel very confident with that.

Now on a particular micro-fulfillment customer, I can only say we're in the learning pilot phase. We have a couple of pilots in operation. I do think that - and the team at Dematic do think that

– it is a promising market, but more than that at this point is quite difficult to say publicly.

Sven Weier: Okay. Thank you, both.

Philippe Lorrain: Yes, good afternoon, ladies and gentlemen. Philippe Lorrain from Berenberg. A quick one on the free cash flow guidance. Overall, the free cash flow generation has been like a little weak this year. And part of that is due to the increase in what I would call the underlying net working capital, which is excluding the contract balance. And on the other side also, the contract balance has become less favorable, although you have had like a very strong order intake at SCS over the past 9 months. So could you please explain why that is and also how we should think about the contract balance going forward, perhaps in the coming quarters and also in the coming years? That's the first question.

Anke Groth: I refrain from commenting the coming years. As you know, Philippe, with SCS, there is always a swing. And the contract liabilities, the contract assets - it depends on the project implementation, the progress we are doing, and on the other hand, the repayments and the building up of contract assets, so depending on the order intake coming in. That always can have swings. And not with all and every customer we do have the same payment terms.

So even if the order intake is very strong, if there are a couple of customers or larger orders where we have different payment terms, then the first milestone payment could come in potentially later. So all that is causing swings. And so it would be really very difficult to predict that now for the years coming.

If we look at the cash flow for this year and also particular the fourth quarter, you know that normally our cash flow is backend loaded, so to say. For this year, in ITS, we clearly have to see the lower level of business activity. And for SCS, we are in the implementation phase of projects, which you also do see in revenues. That has an impact on the overall working capital in SCS. And I already mentioned the payment terms and the cash coming in from the order intake.

So that potentially is the reason why the cash flow in the fourth quarter might not be as strong as you have seen it in the last year.

Philippe Lorrain

Just quick follow up on that, is it fair to assume then that we will pick up on the contract balance then towards beginning of next year and perhaps like over the course of next year?

Anke Groth

Yes, could very well be.

Philippe Lorrain

Okay. Great. And the second question, on ITS, you seem to see a higher competition as what could see that the price mix was deteriorating further in Q3 in the order intake. We hear from you that the Chinese competition in Europe has been a bit more active lately, especially in entry-level warehouse equipment and low-cost IC trucks. So is that something that you have already seen in the past? How do you think about that? And finally, are there any other segments that, say, where you observe such trends in terms of competition?

And perhaps do you think as well that that might actually lead to some erosion of the market share longer term, perhaps like in these kind of truck categories, but like with the chance to actually gain more market share, let's say, in more sophisticated trucks and also in combined solutions, combined turnkey solutions, let's say, offering the SCS products as well as the trucks?

Gordon Riske

Okay. I think that was about 6 questions in 1, but very well packaged. So I'll try to work it off piece by piece. First of all, yes, pricing is a bit more aggressive at the moment and not just from the Chinese, but everywhere. And Chinese competitors are making a big focus on EMEA.

So what do we do about it? First of all, KION is the market leader in Europe in terms of units sold in 2019. We have a huge and dense sales and service network, so people and parts a very big factor. We have a great short-term rental fleet and setup. Sometimes, a second-life Linde truck is much more valuable than a first-life low-cost truck, especially if you have an existing fleet.

And we have extremely high investments, which we've talked about a number of times, in new products, the new connected truck, digital truck, the lithium ion, fuel cells, and automation. And that all kind of fits with our KION 2027 Strategy. We are fighting that battle. We had equity in EP for entry-level warehouses. We've started our counterbalance initiative for value trucks in Poland. That factory is going up sometime in 2021, 2022. We have the warehouse factory for ITS and for SCS, which is now the third factory building in the Czech Republic.

The next generation of China counterbalance trucks, which we talked about in Jinan, will make its way here to Europe in the coming years. So this kind of all fits together with Sven's question. What's the ultimate purpose or the aim? The one side, we have some restructuring, yes, to adapt our capability and cost in the moment, and we talked about the possible savings.

On the other side, we have this huge opportunity. And we have as part of our strategy, which has announced many times, I think made the important moves to be able to at least maintain our very solid position in the European market. I hope I touched all the points that you mentioned.

Philippe Lorrain

Yes, just final one, the Chinese competition, is it something that happens like once in a while that these guys are like really like putting a bit more effort in penetrating the market, or how do you see that? Is it like more like kind of a one-off situation?

Gordon Riske

Well, I don't want to get too political. Maybe one technical and one political answer. First of all, the Chinese have been along - around a long time, and they're innovative and have good products, and we use that. And don't forget, we are a big Chinese player also. So it includes us even with some of our own products coming into the market. But we have all the tools and all the things necessary to be able to compete.

Politically, I would say, right now, what we see in China, there's a society there that is telling the world, "We have overcome COVID-19." Technically and economically, they're investing and trying to become much less dependent on the world, while at the same time keeping all the doors open.

And we spend a lot of time with our Chinese competitors and our own Chinese employees. As I said, they're very serious competitors. We take them very seriously. But we have all of the necessary tools to be able to deal with it.

Philippe Lorrain

Okay. Great. Thank you very much.

Sebastian Growe

Yes, good afternoon. Hi, both. Two questions also for me, obviously. The first one is on ITS and discussing the overall market trends a bit further, if I may. I would be interested in understanding better when you would expect the growth initiative around the value segment to really shine through.

So it has been so far rather been discussed as a I think strategy for China. But given what we're seeing in Europe, and I'm not entirely sure if it's right to make the assessment that, eventually, Europe is a bit saturated on the non-sort of entry products. But what's your thinking around the value segment strategy and as you're taking it more into Europe as well? That would be the first one.

The second one is then on SCS, obviously. And you have expanded your product offering continuously there, be it through M&A on DAI and then also with the minority stake there and then Quicktron.

How should we think really about the impact going forward? So is it just sort of an additional growth enabler, or is it to bring former supplier margins in house? And what's the judgment really on your offering now compared to that of your peers? Is it superior through those very acquisitions which would also then kind of, yes, explain this very strong success that you had? Anything more on this would be much appreciated. Thank you.

Gordon Riske

Okay. So the first one, this whole value segment is becoming increasingly important. We're talking about ITS now. Value for money you can call it. There's a lot of different names, what we name it. Simply, there are customers that are willing or, let's say, take a risk to pay a lower price for certain applications that may not require 24/7 as they're used to from a Linde or STILL truck.

And you know, I think we announced it last year or even a year before, we have a small minority equity in EP, which we use for entry-level warehouse trucks that are rebranded here for the European markets. We also have some products that we do make in China that - in our own organization that are used for value customers in markets. And that I think will increase because the market has increased.

Through these very competitive products, we've actually created a market where people may have not purchased this type of equipment before, or it was manual before in the case of an electric pallet truck is now electrified.

So this is as we do believe a very important segment. That's why we made the investment in the Czech Republic. That's why we are making the investment in Poland for a counterbalance site. And that's why we are making the investment in China to be able to compete globally in this ever-expanding, very important market. So I think we're definitely on the right track.

Whereas SCS, yes, of course, DAI is an enabler. In terms of our offering, I've said it on roadshows. We do have the broadest or we believe a very broad level of products and that we can offer. But I think what's the most important factor now when customers are considering using or cooperating with someone and they have choice A, B, and C is, does the partner have the capability and the project management wherewithal to deliver systems that are larger orders, so 40 million and above, according to our definition, in multiple sites in multiple countries?

And I think this order execution, delivery execution, solution execution is maybe even more important right now than simply having the product of a sortation system or a conveyor belt. Everybody can make a conveyor belt. But try to make that at simultaneous sites parallel to each other in different countries and have that all work out for a go-live that's on time. That's not so easy, especially in this environment, where many big customers are looking to move their business to omnichannel and e-commerce.

Sebastian Growe

Okay. Makes sense. Then just quickly follow up on ITS, and you mentioned also then, obviously, with the value segment, prices have come down quite a bit I guess and eventually even beyond what you would have thought at the beginning of the year. How does that impact your overall and buildout and also the cost curve and finally also then your ability to generate an OK margin, which is not related to the kind of legacy part of the ITS business?

Gordon Riske

Well, don't forget, we have half of our revenues in ITS are services, with an increasing part very, very profitable, very important. We have short-term rental use trucks, all profitable businesses.

Just because the value segment is growing doesn't mean that prices are necessarily going down everywhere. We still have a very important premium, I would say, high-usage customer that the price is the secondary issue because you have a truck that runs at least 6 days a week and on the average of 16 to 18 hours per day every day and knows that, if something happens, Linde or STILL is there within an hour.

And so that is not as price sensitive. But through our ability, and you got to hand it off -- hats off to the Chinese also to make products that are usable for other applications, simple applications, which have a much lower utilization rate, and that's a market that's developing all over the world. And I think that, to me, that's an additional market and explains a little bit about, if you followed us over the years, why has the forklift market grown so extensively? We're actually creating new markets.

And with mobile automation, we will create another new market to take it the next step further because trucks without drivers will - certainly one of the possibilities of future growth.

Anke Groth — And maybe to add here, Gordon, if I look at the margin development in ITS, the development of the prices has a very minor impact on the overall margin development in Q3 on ITS. So it's really not the major influencing factor at all on the margin development.

Sebastian Growe — I was not so much referring to quarter 3, but rather in the long run, but I hear you around the service contribution, obviously, to profit and, with that, also to margin. Yes, okay. All answered. Thank you so much.

George Featherstone — Hi, good afternoon. And thanks for taking my questions. First one would be, given the continued strong demand you're seeing in SCS, do you feel there's a need to raise the long-term expectations in automation systems that you outlined at the recent CMD?

Gordon Riske — Today not. That's probably not perhaps the right thing to do. As I said, we have enough to do to get this year through. As Anke said, as we go through this discussion with workers' council and all that stuff for the group, the next time we make a guidance will be in the first quarter of 2021. It's too early to speculate about that.

George Featherstone — Okay. Thanks for that. Maybe then looking at the capacity in SCS, I know that you talked already about expanding some capacity there. But having seen the level of orders at a sustained high level, do you think there's any need in the near term to expand capacity further?

Gordon Riske — Well, we have done that. Right now, we are able to meet our production requirements. As I said, we recently ramped up our Stříbro site in Eastern Europe, so in Czech Republic, and the US. Our biggest effort right now is not so much in building capacity. I think we have that pretty well under control.

We have a pretty aggressive hiring program in getting people, and we've been quite successful in being able to do that because it's an interesting place to work, a great place to work. And that's our main effort is to get the talent, especially at the project engineering level, to manage these extensive projects. But for this year, we're well on track.

Anke Groth — And, Gordon, with respect to employees, up until now, we already hired a record number of 700 to 800 engineers also in order to prepare ourselves for implementing all the projects.

George Featherstone — Okay. Great. Thanks for the color.

Felicitas von Bismarck — Yes, thank you very much. I have one question still on your cash flow, about the rental assets and the rental liabilities. As far as I

	understand, so you basically got less in, less money in from selling the rental units versus what you have to pay back to the banks in rental liability. Is that a temporary effect? Because as far as I remember, in 2009, shrinking the rental fleet was a major cash inflow, or is that something that is just the way it is?
Anke Groth	It's not a one-time effect. It depends on the age structure you do have because, what is happening, it depends on depreciations. And so you have the asset value which is typically lower than the value of the refinancing liability based on the depreciation of the asset as done on a straight-line basis and the liability as done on an effective interest method. And so the, so to say, depreciation costs are different. And it depends really on the age of the assets and the structure to build up this effect or to counter this effect.
Felicitas von Bismarck	Okay. So basically, in the last crisis, it was just a younger fleet? Is that how we should interpret that?
Anke Groth	Yes, probably yes.
Felicitas von Bismarck	Okay. Thanks very much. And on the second question, thank you very much to list the EBIT impacts in Industrial Trucks. That was very helpful. Some of the companies were also able to tell us basically the temporary COVID savings from less traveling and less installation costs, industry fairs, temporary workers. You already mentioned the provision release, but apart from that, is there anything you could help share?

Anke Groth	No, we said the temporary cost savings, which I mentioned in the ITS segment, Felicitas, these are roughly €36 million, and this is comprised of personnel measures, so short-time work and overtime accounts, but also traveling, marketing expenses, and so on are part of that €36 million.
Felicitas von Bismarck	Okay.
Anke Groth	So if you would ask me, so I would say one-third is costs like traveling, marketing, and so on, and two-thirds are personnel measures.
Felicitas von Bismarck	Okay. But the personnel measures that are in this €36 million are not structural measures in any way. It's just temporary short-term work schemes.
Anke Groth	Absolutely.
Felicitas von Bismarck	Okay. Perfect.
Anke Groth	Up until now, yes. As mentioned, we are currently negotiating more sustainable measures with our workers' councils.
Felicitas von Bismarck	Understood. Thank you very much.
Katie Self	Hi, thanks for squeezing me in. I just had two. The first one was on leverage and SCS. You've obviously seen pretty good continued growth there, but the margin's kind of flattish year-on-year. I'm just wondering. What level of volume growth will actually result in some leverage kind of coming through to that bottom line, and what is it that's stopping that now? Is it about the cost

related to DAI or site access, or is it really just about ramping up the business?

Anke Groth The latter point is correct, ramping up the business.

Katie Self Okay. Brilliant. Thank you. Clear. And then my second question was on mix in ITS. We've been chatting about the sort of lower-value segment with the Chinese competition versus some of the higher-value segments. Can you give us just a rough breakdown of what your exposure is to those different areas within Europe?

Gordon Riske Not quite sure I understand the question. If we talk about warehouse product specifically in Europe, it's about 55%, 60% of the total market in warehouse, and in the warehouse, probably half of that is smaller, simpler units. So then that leaves 40%, 35% or so as the counterbalance truck, and that's, at least in Europe, about even now with the electric trucks taking over the lead, so more than 50% of the 35%.

Katie Self Okay. Thanks. Thanks.

Stefan Augustin Thank you. I just want to return to Q4 and the ITS segment. So from all the questions before, I get that, in the midpoint of the guidance, you more or less expect some growth in the volume in the ITS segment in Q4. But even if we strip out the €9 million, there seems to be the additional volume, and the operating leverage does not go in line with the lower temporary savings.

So as the price is not the major impacting factor likely, my question is, what -- let's say, which temporary savings go away quicker than the volume returns, or is mix rather the better

	interpretation that your current order book is, let's say, a lot on lower margin trucks?
Anke Groth	Yes, thanks for the question. So yes, we do have less temporary savings next quarter because we do expect less short-time work and less personnel measures. Additionally, we have the continuation of the strategic projects, so the strategic costs for the couple of projects we have mentioned. And the R&D costs which you might also have seen are slightly up already in Q3. And last year, it was backend loaded, and this year, it will also be backend loaded. So I also expect higher R&D costs in the fourth quarter in comparison to the fourth quarter last year.
Stefan Augustin	But let's say the temporary Q4 burden with the R&D should go away with Q1 next year, or is it something we should, let's say, expect to stay there?
Anke Groth	No, I would expect it to stay there.
Stefan Augustin	And what about the interpretation of the mix and the backlog?
Anke Groth	The new business, the percentage of new business is going up slightly.
Stefan Augustin	Okay. Thank you very much.
Richard Schramm	Yes, good afternoon. Just a quick clarification, please, on this extra cost you plan for ITS. So this increase in NRIs we have seen so far this year toward €25 million, this has not a relation to this project, but all these extra costs are still in negotiation and will be booked in Q4. Did I understand you correctly in this respect?

Anke Groth	No, I pointed out that already €12 million in these NRIs are referring to the program because we started already in some of the countries, to mention UK as the largest country here and also some other smaller European countries. So within this €25 million, you have a write-off of Linde Hydraulics. It's a 10% participation we still have, plus the €12 million I just mentioned for this structural program.
Richard Schramm	Okay. And the additional cost, as you gave no figure yet, but you said should be in the same ballpark, do you refer to these €12 million, or is it more toward the total number we have so far with €25 million?
Anke Groth	No, I said that we expect savings in the range of high double-digit to low three-digit million per year once the program is fully implemented. And I said that, on the cost side, I would expect the same level of magnitude, potentially slightly lower, and as also said, €12 million we have already provisioned for, and the remainder will come once we have finalized the negotiations.
Richard Schramm	Okay. That's then clear. Sorry that I didn't get that right. Thanks.
Sven Weier	Yes, thanks for taking the follow ups. It's two actually. The first one is I'm still curious about the structural implications you thought about as a result of corona. First of all, I was wondering, does it also have a structural implication on the rental business, i.e. do you foresee different kind of demand also longer term as a result of the crisis, i.e. less demand from trade shows, from festivals, and so forth? So does it mean you have to right-size the rental business structurally as well?

And do you also see -- the strategic initiatives you mentioned, they have a certain R&D product focus. Do you have to fine-tune that as well with regard to different market needs? That's the first follow up.

Gordon Riske

Yes, we did already make some corrections to the rental fleets. That has been done because, just as you say, no Winefest - and that's just terrible here in the Rheingau - no rallies, no Christmas markets. So that's not great for business. So we had to make some changes there.

But for the longer-term thing, whether you call it rental, whether you call it a 3-year lease contract, whether you call it pay on production, I think this whole topic of not owning assets, but using the service or service, that will continue. And so I think, strategically, with our sales and service network being so dense and being able to maintain such a rental business is also longer term, will stay a big part of our business.

Sven Weier

And in terms of the R&D focus in general regarding the measures you do this year, obviously, you've done that framework before corona, right?

Gordon Riske

Yes, the R&D - fact is we have a number of fronts that we're working on. First of all, if you look at Europe, the whole change to warehouse equipment, the whole change to electrification, we've talked about our 120X program, which is E = IC, so same platform, same production capability, lots and lots of carryover parts between because you don't know how fast the ramp up will be, the connectivity part of it and then the energy source, from engine to electric, from electric to lithium, from lithium to fuel cell. So all that means R&D, means investment. We've announced our joint venture with BMZ and so forth. That's kind of the European front.

At the same time, we have the Chinese, our big effort in our factory in Jinan, also for the next generation of what we call a KION global counterbalance truck, meaning also for the value segment, same platform for electric, same platform for engine-driven trucks, huge flexibility in that. It's just a much different cost and also, from the spec, a different specification than what we have than somebody needs a 24/7 truck, but for lighter-duty applications.

So we have our R&D teams working on both of those very important projects. And where they all come together is the topic of energy. As you know, China is the hub of the world for lithium ion and fuel cell technology. So that's where everyone works together, including with our shareholder Weichai Power.

Sven Weier

And the second follow up ties into what Stephan asked earlier because I was also wondering. When I look at the Q3 EBIT margin in ITS, which is obviously lower than in Q1, especially if we consider this €9 million one-off, on the other hand, when I look at the sales mix, you were higher than in Q1 in rental. You were higher in aftersales, which is typically, obviously, high margin. You have much higher temporary savings than in Q1, but yet the EBIT is lower.

So is that because the mix within the equipment mix is so adverse that this takes off all these benefits basically?

Gordon Riske

Yes, good. No, we do have -- don't underestimate the -- some of the efficiencies in COVID, as you know, and especially in the second quarter, and third quarter was not so bad, but all the time, even some of our suppliers, you have, “Okay. Three people are infected. So now we take out an entire assembly line for a week.”

And so we do have a lot more, let’s say, noise around getting parts in and out. And I don’t want to start the song again, we can’t get parts like in 2018. This is a little bit of a different case. But as I also mentioned in my opening statements, we do have -- from a mix standpoint, we are -- especially the STILL brand has great market shares in automotive and automotive related, which are higher-profit trucks, so bigger trucks.

And anyone that’s covering anything with automotive knows that’s down, in some cases, quite significantly because of their own change to electrification. So that is certainly a factor. And perhaps some competitors there are more active in warehouse, food and beverage, and key accounts that that could be a temporary thing, but that will come back.

Anke Groth

In addition, we have also some FX effects. You might have followed the press around Turkey and the Turkish lira. Also, Russia is not running into our favor, and Poland as well. So there are some additional effects, Sven, back and forth in Q3 which are then of minor nature, but they can also add up.

Sven Weier

Okay. Thanks for the color, Anke and Gordon. Thank you very much.

Philippe Lorrain

Yes, thanks. Also, like just a couple of follow ups. It’s just to better understand the NRIs that you are speaking about. Is that all going to be booked in Q4, or should we expect some stuff to be booked in Q1, Q2 next year?

Anke Groth — No, it could also happen that some of the NRIs can be booked next year. There are some countries, and for example, it applies to Italy and Spain, where we are getting governmental support with respect to short-time work and so on. And this prevents us from negotiating measures now and putting measures in place. So there are some countries where I would also expect NRIs and going to be booked next year.

Philippe Lorrain — Okay. So I understand that there is no precise guidance on the NRIs for this year just because you don't know exactly how much you can book and how much you can book next year.

Anke Groth — Yes, that's right, Philippe.

Philippe Lorrain — Okay. Perfect. And then the second one is just like on the -- you made an interesting point with the rental fleet. Speaking about the cash outflow that comes despite the reduction in the rental fleet because you pay back the debt, have you considered actually defining the free cash flow differently as, let's say, in an upcycle, you would end up getting a cash outflow from the pure investment activity in the rental fleet, which is partly offset by the increase in debt? And then you might have actually the reverse in the downcycle.

Anke Groth — Not yet, but interesting approach, and we should discuss it offline, Philippe.

Philippe Lorrain — That's what I like. Thank you.

Daniel Gleim — Hello, good afternoon. Thank you very much for taking my question. The first one, Gordon, you mentioned the regional focus of the ITS right sizing being EMEA. Could you also elaborate on the focal point by product groups, i.e. as warehouse, electric, and internal combustion engine counterbalance trucks? This is the first question.

And very related to that, the second question, could you elaborate a little bit on what your EMEA end market assumptions are that inform that right sizing? So if you could comment on the total market trend up or down and what will happen to the mix in your opinion in between these 3 product categories, that is to provide us a little bit of context for the right sizing. Thank you.

Gordon Riske

Well, we see in our SCS segment e-commerce is growing rapidly. Solutions become more important. And we have seen for the last years - this is nothing new - that the electrification of trucks is going faster than most people thought. That's why it was so important for this new truck platform, which only happens every 15 years, to have total flexibility, regardless if it's an E-truck or an IC truck. So for us, going forward, it won't be so important. We can easily change.

Now the area that we're restructuring is correct, EMEA, but as Anke said, we're in the middle of negotiations and I think in a very professional, very good, and trustworthy way. And at this point, if I say it's this factory or that factory, that would not be helpful. And so please bear with us here for a couple of months. And then everything will be clear. But we would not like to get into specifically where because it is a very sensitive topic right now. And we would like to keep it at a good level that we have right now.

Daniel Gleim

And maybe on the absolute end market development?

Gordon Riske	Well, the trend is towards electric truck and warehouse for sure, and there will always be a smaller segment, but an important high-profitable segment for engine-driven trucks above 3 tons. That will always be there. And we have an excellent, excellent position there. That's why we need that product also. But the bigger trend is certainly towards warehouse and electric.
Daniel Gleim	Fully understood. But do you expect the absolute end market level to exceed the end 2019, end 2018 levels in the foreseeable future?
Gordon Riske	Too early to say. So let's get through this COVID and get back to normal. As a general tendency, the end markets have grown over the years. I see no reason that that would change the need for moving goods and services, regardless of type of truck. That will stay in place. And the e-commerce will increase, so I think, as a general trend. You can see by the level of our investments that we're taking that we do believe the end markets will continue to grow.
Daniel Gleim	Very clear. Thank you very much.
Operator	Ladies and gentlemen, in the interest of time, we have to stop the Q&A session, and I hand back to Mr. Gordon Riske for closing comments.
Gordon Riske	Yes, thank you, all, for participating. The only important thing I can say is please stay safe with your families and yourself, and we look forward to upcoming calls, I hope in person, as soon as possible, and then we will announce our full year numbers then early next year.