KION GROUP AG

Q3 2022 Update Call

Conference Call Transcript

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Speakers: Rob Smith (CEO and CFO Ad Interim)

Rob Smith

Thank you, Stuart, and good afternoon, ladies and gentlemen. For today's call, please refer to our Q3 presentation on our IR Website.

I'd like to start with a few minutes on the announcement we made last week regarding the completion of our Executive Board with the appointments of Marcus Wassenberg as Chief Financial Officer and Valeria Gargiulo as Chief People and Sustainability Officer.

Marcus Wassenberg will join us from Heidelberger Druckmaschinen AG, where he is the CFO, and prior to that, Marcus served as CFO at Rolls-Royce Power Systems AG and Senvion AG. He has strong industrial and project business experience and actively engages with capital market participants.

Marcus's responsibilities at KION will include accounting, controlling, finance, and IT, as well as M&A and Investor Relations, and we expect Marcus to join us by the 1st of April next year at the latest.

And Valeria Gargiulo will join us from Daimler Truck AG, where she serves as the Vice President of People and Organizational Development. And with over 30 years of experience in HR, sales, legal, and M&A, she brings extensive international experience and an excellent track record in organizational development, including building trustful relationships with social partners.

And as an active member of the ESG Steering Committee at her current employer, she's instrumental in developing and implementing a state-of-the-art sustainability vision and process. Valeria will come and join us as our Chief People and

Sustainability Officer by the 1st of May next year at the latest. And she'll take up the role as our Labor Relations Director as well.

Her responsibilities at KION include groupwide HR, health and safety, and sustainability. And based on Valeria's many years of experience in the areas of environment, social and responsible corporate governance, she'll sharpen our group's sustainability profile and ensure targeted implementation of our sustainability roadmap as part of our KION strategy.

Today, I'll talk you through our Q3 highlights and then through our market update and financials and end the presentation with an outlook for the rest of this year and take your questions.

I start with our key financial figures on Page 4. You will recall we provided indications for our Q3 result in our ad hoc announcement on 13 September. Overall, KION delivered in line with what we announced in September and at the higher end of the expected adjusted EBIT range.

Order intake was down 19% year-on-year to €2.5 billion. Despite continued challenges from supply chain disruptions, the KION team delivered a strong revenue of €2.7 billion euros, up 5% year-over-year and down 3% quarter-on-quarter.

In Q3, we had to recognize significant catchup costs in our project business within our SCS segment, as announced on 13 September. This was the main driver of the quarterly adjusted EBIT loss of €101 million in the third quarter, which came in at the higher end of our September indications.

As detailed in the Q2 call and in the call following the September announcement, we've initiated multiple measures to address the decline in profitability and to sustainably strengthen the resilience of our business.

Free cash flow was minus €380 million in the quarter, reflecting the continued buildup of net working capital. Earnings per share were minus €0.73. And in our 13 September announcement, we provided an outlook for the rest of this year, and we confirm this outlook today.

Some strategic highlights on Page 5, three of them, illustrate quite well the progress we're making in implementing our KION 2027 strategy. Let's start with the partnership that Dematic entered with warehouse robotics provider Dexterity to offer full-task robotics as a part of Dematic's integrated automation solutions.

By combining trusted expertise in advanced supply chain solutions with premier robotics technology, the Dematic and Dexterity partnership is expected to provide fully integrated, autonomous, and scalable solutions to the market.

Linde Material Handling expanded its AMR portfolio to include two core products from Munich-based company idealworks. These intelligent autonomous mobile robots navigate freely, actively avoid obstacles, communicate via the Internet, and can be used in a wide variety of warehouse areas.

And the third example is the product launch STILL is planning, the Xcellence Line, which will offer one of the most advanced technologies for demanding applications. The centerpiece of this line is the RXE series, the next generation of electric forklift trucks. And it will set new standards in energy efficiency and sustainability, with energy consumption up to 17% lower than with its predecessor.

Let's move now to the market and the financial update, starting with the Industrial Truck and Services global market on a unit order intake basis. I'll show you the development of the market, and I'll show you how KION is performing relative to that market.

As you know, the data is 3 months delayed, and so we now have the data from the global industrial truck market for the second quarter, which globally declined by 9% on a unit basis. KION's decline of 2% on a unit basis demonstrates continued market share gains across all regions.

And coming now to the third quarter and our assumptions for the market, we expect the market in all regions will have been down substantially in the third quarter. And that's in line with our expectations that the market dynamics will normalize in the second half of this year after exceptional demand in previous quarters. In the longer term, we expect the ITS market to grow stronger than global GDP.

KION's Q3 order intake came in at 53,500 units. And compared to the third quarter last year, the decline was mainly driven by warehouse trucks, whereas the decline was less significant for electric counterbalanced and internal combustion trucks. And in total, the share of electrified products remained stable at 88%.

Let's look at the key financials on Page 8. Although the order intake in units was down 15% year-on-year, the order intake in euro was still up 11% to €1.9 billion, driven by list price increases as well as an 11% growth in our service business.

Order backlog remained stable sequentially and increased 84% year-on-year to more than €4.2 billion, covering more than a year of new equipment sales.

Q3 revenues and adjusted EBIT in ITS came in better than anticipated in our 13 September release due to increased shipments of trucks in the last 2 weeks of the quarter. And revenues increased by 13% year-on-year, 6% quarter-on-quarter, reaching €1.8 billion.

Thanks to this additional volume and overcoming continued high procurement costs for materials, energy, and logistics, the adjusted EBIT in the third quarter increased sequentially by 23% to reach €103 million and an adjusted EBIT margin of 5.6%, up 80 basis points from the previous quarter.

Slide 9 gives you an update on the measures we are implementing in our Industrial Truck and Services business to sustainably strengthen the resilience of our business.

We continue our focus on agile pricing and commercials, and we call this commercial agility. So far this year, we've raised the prices on new trucks four times in EMEA: in January with a mid-single-digit increase, in April with a high single-digit increase, in July another mid-single-digit increase, and at the beginning of October a fourth increase which was mid-single digits.

This agility on pricing and commercials applies to our services business as well.

To strengthen the resilience of our business, we've also implemented price adjustment clauses in all new orders since the second quarter of this year.

By the end of the third quarter, about one-fourth of our backlog now includes these clauses, and the backlog quality is improving due to the year-to-date price increases.

For backlog repricing, let's address that. We've now spoken to more than 80% of the customers who have orders in our backlog placed prior to April of this year, and we've asked them to participate in the higher procurement costs.

Even though there were no contractual escalation clauses in place with our customers on these contracts, our sales team has achieved with our customers in trustful and respectful negotiations a mid-double-digit million-euro improvement in pricing. That goes straight to the bottom line. About half of that will go in the second half of this year, and the other half will go in the first half of next year.

I think this is an excellent effort from our sales team and a very strong proof of the quality of our long-term trusting and longstanding relationship with our customers and the competitive advantage we bring them and importance of our products and services to their business operations.

Do keep in mind, though, that the basis for the backlog repricing was substantially increased costs for materials, energy, labor, and logistics on those orders.

We're proactively working with our customers to prolong their leasing contracts. That's a win-win. It secures them ongoing availability of the trucks at their sites, and it provides additional income for us.

We're also working on our operational agility. We've successfully managed -- I think this is a statistic we've monitored together in the calls over the quarters. We've been able to reduce the number of semifinished trucks in inventory from about 12,200 trucks at the end of the second quarter to now less than 8,000 trucks at the end of the third quarter. And we continue to progress this reduction in work-in-process trucks.

To improve the availability of components in our supply network, we've successfully reduced the number of critical suppliers from mid-double digits at the beginning of this year down to a couple today.

We're not just qualifying additional suppliers, but we're also enabling better material availability by redesigning electronic components to switch to different chip technologies that are more available in the market.

Let's move now to the Supply Chain Solutions business and starting with the supply chain market. We expect that the market will be impacted in the short term, which means '22 and '23, from the slowdown in capex investments from ecommerce retailers as well as project delays due to economic uncertainties.

We continue to expect that the market for automation will grow better than 10% year-on-year and the long term. And the trends and drivers in the SCS market, such as automation, labor shortages, urbanization, those remain intact and underpin our Supply Chain Solutions business and business model. In addition, we expect that the service business will continue to show resilience and post further strong growth.

Now let's take a look at our pipeline. It remains solid despite the anticipated weaker ecommerce verticals and some project postponements due to the economic uncertainty. It's below December last year's levels, but it's above the third quarter levels of last year and remains good and solid.

Page 11 summarizes the financials for Supply Chain Solutions that were the centerpiece of our announcement on 13 September. Q3 order intake is down 56% year-on-year on some very tough comps, and we finished at € 614 million.

This development was driven by the rare occurrence of two sizable order cancelations, as I mentioned in the September call. And in addition, the overall uncertain economic environment has led some customers to postpone their decision making on certain projects.

We were able to partially compensate. You'll see, a year ago, it was 50% ecommerce in the order backlog. In the third quarter of this year, it was 1%, and we were able to compensate the low share and the reduction of ecommerce business by orders in the apparel and the wholesale verticals.

At the end of September, our order backlog finished at €3.5 billion and continues to provide good visibility for the quarters to come.

Revenue in the third quarter was €874 million, and reflects the cost catchup effects mentioned in the 13 September ad hoc release.

Higher than previously planned project costs reduced the percentage of completion of the projects. And this effect negatively impacted the revenue line and more than offset the further strong growth in the services business. Our Supply Chain Solutions services business grew 27%.

The adjusted EBIT loss in the third quarter of €182 million reflects the cost catchup in the project business due to higher cost, project costs to completion, and supply chain interruptions as well as our limited ability to pass on cost increases to customers on orders received before May of 2022, when we worked on putting the contractual protection measures in our contracts.

We continue to focus on safeguarding our customers' schedules by purchasing in a higher priced spot market in order to secure components. And we keep our labor forces intact and ready to install equipment when material does arrive on site.

For your reference, we've included examples of how percentage of completion accounting works in the backup of this Q3 presentation. And our IR team would be happy to take you through it for clarification later.

Let me refresh all our memories on how our project business works in Supply Chain Solutions. Here's a typical project timeline. We start with the solution development phase, where we discuss specific projects with specific customers and, based on their requirements, tailor a solution for them and develop this solution concept as well as performing simulations with them together with our customer.

Discussions in this phase can last between 2 and 24 months. And that's why we have good visibility to our project pipeline and why we say our customers really look through the cycle and cancelations are very rare.

At the end of this phase, we have a signed order, and we record the order intake for the project going into the backlog. And that's usually accompanied by an advanced payment from the customer.

The second phase is the project implementation phase, with the project engineering, the manufacturing of our components, the sourcing of further components, and the installation of those on the customer site. This phase can take between 6 and 24 months, and some of the larger projects can go 36 or even 48 months.

Revenue is recognized as the project progresses using percentage of completion accounting.

And then the third phase is between 15 and 25 years and is the services phase, with service support, spare parts support, and modernizations and upgrades on existing installations.

Let me give further clarity to the measures we are putting in place to improve profitability in our Supply Chain Solutions business. On Page 13, we discuss how we're working to consistently improve the performance going forward.

We're improving our sourcing and sales approach. We have implemented price adjustment clauses in all new orders at Supple Chain Solutions since the second quarter this year. In addition, we're reviewing our contractual terms and conditions and updating them where it gives us better resilience for our business.

And we're working with our suppliers to lock in our costs early in the project lifecycle and improve the reliability of the supply of key parts and components on our sites. This gives us better visibility so we can more efficiently deploy our project teams and reduce the cost of inefficiencies on installations.

Our project implementation and project management processes have served us well in times of stability and more stable macroeconomic environment. And we're updating these processes, so they deliver good profitable growth in these volatile times.

These include improving the interfaces between critical workstreams, hardening our project gates, and strengthening our project management and controlling capabilities by adding capacity and strengthening the capability in project management and controlling and intensifying our risk mitigation measures across the whole project portfolio.

These aren't quick fixes, but they are self-help measures. And these will safeguard our profitable growth path in this volatile economic environment.

I summarize the key financials for the group on Page 14. Order intake at €2.5 billion and order backlog at €7.7 billion continue to provide good visibility and good workload for the quarters to come.

At €2.6 billion, revenue remains at a high level, despite the supply chain interruptions and adverse cost catchups in the project business.

Group adjusted EBIT and adjusted EBIT margins were negative due to these cost catchups and came in at the higher end of our band announced on the 13th of September.

Page 15 reconciles adjusted EBITDA to group net income. The high cost catchup effects in the project business was the main driver of the net loss of €93 million in the third quarter, which corresponded to a negative €0.73 per share.

Nonrecurring items in the quarter, €5 million more write-offs on our business in Russia, and despite increased interest expenses, the financial expenses improved in the quarter due to the favorable development of fair value of interest rate derivatives.

The tax credit in the third quarter relates to the negative pretax result, and there were no deferred tax assets recognized in the write-off relating to the Russian business.

Page 16 and the free cash flow: In Q3, free cash flow was negative €380 million. This was an expected deterioration compared to the second quarter and relates to the continued buildup of net working capital.

Even though we did deliver a significant amount of finished trucks at the end of the third quarter, in those last 2 weeks, they're still reflected in the increased trade receivables and not yet in the cash flow.

In addition, in order to safeguard our production, we prebought and temporarily stockpiled certain materials and components from suppliers where we have some concerns over potential supply capability as a result of the escalating gas crisis. We did that to take our production through the winter with better visibility and stability.

In Supply Chain Solutions, we've also had an increase in net working capital, not just due to the delay in reaching milestones but also resulting from lower customer prepayments as a consequence of the lower order intake.

Page 17, you see our net financial debt increased by €428 million in the quarter to almost €1.9 billion. The leverage ratio, based on net financial debt, increased to 1.5x.

The leverage on industrial net debt, excluding pension liabilities, is a good proxy on how our banks would calculate our leverage if the covenant was to be tested. This leverage ratio was 2.3x at the end of the third quarter, and there remains plenty of headroom under the covenant.

As a reminder, there is no covenant testing as long as we have two investment-grade ratings, and Fitch confirmed their investment-grade rating last week.

High interest rates have a positive impact on our pension liabilities, which nearly halved year-to-date. Including pension liabilities, the leverage on industrial net debt amounted to 3.8x at the end of Q3.

Slide 18 shows you our historic leverage development and the maturity profile. You can see, while leverage today is temporarily high, it's not unfamiliar territory for us. But in contrast to periods in the past, today, we have a very high order book of €7.7 billion, nearly twice as high as in previous periods with elevated leverage ratios. And that gives us very good visibility for the coming quarters.

The temporary negative high cash flow is related to net working capital buildup, which we're working hard to unwind in the coming quarters. But until then, you see we have adequate liquidity and access to various different funding sources.

Page 19 demonstrates our very solid financial profile. Our negative free cash flow is first and foremost a function of temporary significant net working capital buildup, and we're actively managing this in our businesses.

In ITS, it's about reducing the working capital and reducing the unfinished trucks. We've dropped the trucks to below 8,000 and are going to continue to drive that down.

To safeguard the flow in our production, we did prebuy certain materials that we thought would be subject to certain potential reliability or delivery problems in the escalating gas crisis. And we've prestocked those in order to ensure our production flow.

In Supply Chain Solutions, the focus is very much on completing the project milestones and invoicing our customers to get paid.

Our financial profile is solid. During the quarter, we were able to extend the maturity of the revolving credit facility to 2027 with an option of extending it another year. Between June and October, we secured further bank loans amounting to €600 million in total, all at favorable conditions.

We enlarged our commercial paper program to €750 million and have just under €600 million outstanding at the end of September. We also have €3 billion in European midterm note program, of which we have used €500 million so far.

We have more than €1 billion of available liquidity, and we more than cover our financing needs. We do not require a capital increase.

Our overall guidance for the year is on Page 21, where we show the guidance we provided on 13th of September, and we reconfirm this guidance today. Please note we put a chart in the back on housekeeping items that'll help you with your models.

I summarize my key takeaways on Slide 22. We are looking forward to welcoming Marcus Wassenberg as our CFO on April 1st at the latest and Valeria Gargiulo as our Chief People and Sustainability Officer from May 1st at the latest.

KION's business model is intact, and we will deliver profitable growth with the measures we have implemented to strengthen our business resilience and improve our financial performance in this volatile macroeconomic environment.

KION's financial profile is solid. We have more than adequate liquidity to cover our working-capital-driven financing needs. And we reconfirm our September outlook for the full fiscal year.

This concludes my presentation. I'd really like to move to the questions and answers now, please. Stuart?

Operator Ladies and gentlemen, at this time, we'll begin the question-and-answer session.

Sven Weier Yes, good afternoon. Thanks for taking my question. Hi, Rob. The first one is actually on the order intake guidance you've given for SCS. You confirmed it today despite the relatively low level in Q3. The lower end implies over €900 million for Q4. I was just wondering, with October almost completed, if you reckon that this is going to be a backend-loaded quarter on SCS orders, or have you already seen some evidence that the orders are coming through?

Because you mentioned people are more hesitant to place the orders, right, because of the macro circumstances. And I just wonder -- and that's probably not going to change during the quarter. And yes, that's why I think it would be interesting if you already had some evidence for the guidance. That's the first one. Thank you.

Rob Smith Sure, Sven. Good to talk to you. Yes, we have seen some orders come through in October, and yes, we do reconfirm our guidance as stated in September. I think it's important to understand that €600 million. I think it's important to draw the comparison. At €1.4 billion a year ago, 50% of that was ecommerce. Today, it's about 1% in the third quarter.

We obviously expect that to come back over time, but there's a certain catchup effect in that ecommerce vertical. And we've been able to compensate. So that reduces the comp to €700 million. We had two projects that got canceled. Those are quite unusual. They're understandable. Those were about a high double digit million euro amount.

And one of them was, for example, a customer chose to move their location from one state in the United States to put the automation capabilities on a site they had in a different state. And as we talked about a longer planning cycle, we had to stop that project with them and restart a project to help them plan on another location they have in a different state.

So, there was some postponement. There were some cancelations. They're very unusual. And that was double digit million euro amount.

So that actually demonstrates that we were able to compensate quite a bit in the apparel vertical and the whole goods vertical. And I think that that was a good performance. And we do expect that, where -- with the postponements from Q3, I think that's the best way to understand the €600 million. We reconfirm our guidance on the order intake on Supply Chain Solutions for the full year.

Sven Weier

Okay. Thanks for that. The second question is just a people question basically because you mentioned some of the issues in SCS obviously have to do with labor shortages and problems related to that.

I was just wondering. I think, 2 years ago, you hired 1,000 employees in the US, right? And I think, back then, the growth was very much dominated by your one big ecommerce client, which I guess is more of a hardware client and maybe less of you required in terms of project execution, project implementation.

And now that the mix is changing, right, to other clients where you do more of that stuff, do you feel that this is also the question whether you have the right people onboard now, whether you need to make changes, or can you also implement those people also on the other type of projects?

Rob Smith

Good question, Sven. No, we have confidence in our team. The project implementation is key for ecommerce customers as well. And as I talked about, we're adding capacity in our project management, adding capacity in our project controlling, and we're also upskilling our teams over time as well, as technology changes over time. So we've got good capabilities in place.

In North America, there is a labor shortage. And there's some competition with other industries such as oil and gas. We're working through that, and we have a strong recruiting program underway where we need it, and we have a good upskilling program underway where we've got it.

Sven Weier

But it's not an issue related to the 1,000 you actually hired.

Rob Smith

No, it's not related to the 1,000 we hired, and we've been hiring more this year.

Sven Weier

Okay. Thank you, Rob. I go back in line.

George Featherstone: Hi, Rob, and hi, everyone else. I'll do one at a time again with my questions. So I just wanted to start with the improvement in the supply chain environment that you talked about in IT&S in the last 2 weeks of the quarter. Essentially, how much of the unfinished trucks balance do you expect to complete through Q4? And maybe can you touch on what it is that specifically happened that's changed in the environment for you to be able to deliver more in those last 2 weeks?

Rob Smith: Sure, George. Good question. I'm not saying that the overall supply availability is improving significantly. As a matter of fact, the volatility in the market is probably increasing over time with the different macroeconomic environment and geopolitical environment that we all see and are working in.

So there was a very significant push on getting the machines out. There was some good availability of some key components that helped us in those last couple weeks of the quarter. And there's a certain amount of volatility. That's one of the reasons we were stocking components that we think might be affected by a gas shortage during the quarter.

So it was a good strong push. And the component availability did help us make that push, but it's not a continuous flow of material to us, and that's something that we're working through.

We finished the quarter below 8,000. And I think that's a very significant -- that's the first time this year that we were below the end of last year's levels, and we're on a good way on reducing it further. We're working to get that below 5,000 by the end of this year.

George Featherstone: Okay. Thanks. And then second question would be on the balance sheet. You've clearly got a lot of cash tied up in current assets. How much of this do you expect to unwind in Q4 and then in Q1 just in terms of the phasing of it? Could you quantify it, if possible, as well?

Rob Smith: We're expecting to drive a working capital reduction in our ITS business over the course of this year. As a part of that -- or the course of the quarter as we're driving down the work-in-process trucks.

And I think that you can see in our guidance our expectation is to have a positive EBIT in the fourth quarter, leaving the negative EBIT behind us, as well as a positive free cash flow in the fourth quarter, leaving the negative free cash flow behind us. Supply chain issues will go on throughout 2023, however. And so we're working the net working capital on a real-time basis as material's available and as we're able to drive work in process out and drive finished goods down.

George Featherstone: Okay. Maybe just a quick follow up then. You said some of the accounts receivable balance haven't changed because those trucks you delivered in the second -- or the last 2 weeks, sorry, of the quarter weren't flowing through there. Could you give us a steer as to how much the delta would've been it hadn't gone through the cash flow?

Rob Smith: You answered the question to an extent, George. It's one -- and I was going to point it out to somebody who didn't ask. If you do have that significant reduction of finished goods in the second -- last 2 weeks of the month, and the receivable terms are longer, then it does go into trade receivables.

So the stock went down. The receivables went up. The good news is it's out of our factory. It's in the receivables. And our customers are good at paying. And we expect those come in and turn into positive cash flow for us.

George Featherstone: All right. Thank you very much.

Daniel Gleim: Yes, good afternoon, Rob, and thanks for taking my questions. The first one is on the SCS market projections on Slide Number 10 and your direction of a management assumption of a mid-single-digit decline in '23. Since this chart is not in units but monetary value, let me ask whether the indication is in real terms or inflation adjusted and, if it is adjusted, what the inflation assumption is. This is my first question.

Rob Smith: Okay. You're right. It is in euro terms. And you're right to ask. It is not inflation adjusted.

Daniel Gleim: You also spoke about price increases in ITS. And I wonder if you could comment on SCS price increases as well, specifically if there's already been significant enough to enable a return to the 12% plus margins in the medium term.

Rob Smith: Well, Daniel, yes, I talked about price increases in the ITS business. And that was a function of being very aware of the cost developments in the market and making sure that our pricing stayed in line or ahead of that.

We're also based on cost and design margins in our Supply Chain Solutions business. And we're very aware of the inflation in the market. We're very aware of the cost base. And we take those into account as well as the competitive advantage that our installations are bringing our customers as we're pricing these contracts. It's important to have the looking-forward cost expectations in mind, and we do, as we are pricing our Supply Chain Solutions business.

And you bring up our medium-term targets. We confirmed in our 13 September, our release, we see those as realistic and appropriate for KION for Supply Chain Solutions and also ITS. The timing of achieving those we're reviewing because it's a very volatile environment, and we will get to those over a period of time. They will not be next year. I think you can understand it. And we'll be reaching those over the midterm.

We have costs in our projects that have reduced the project margins. And those will roll off in a decreasing amount over the next six quarters. I think that's important to understand.

The protection clauses that we've been putting into our Supply Chain Solutions and ITS contracts since the second quarter will roll on over time. And so, there'll be an increased amount of backlog that's protected with contractual clauses. There'll be a reducing amount of backlog that's unprotected over time.

Daniel Gleim — Have you previously indicated when you could confirm the new timing for midterm guidance achievement? Is this something you mentioned?

Rob Smith — No, and not going to mention it today either, Daniel. We'll be coming back with next year when we come back with this year's results, and we'll be talking about the midterm timing in due time.

Daniel Gleim	Perfectly clear. Thank you very much.
Akash Gupta	Yes, hi, good afternoon, everybody. It’s Akash from JP Morgan. My first one is on guidance. And, Rob, you said that we’d be mid-double-digit pricing tailwind, and you expect half of it in second half. The question is that, is this half of it in second half, was it known a month ago when you gave the guidance? Because there was no -- like you didn’t mention anything on that front. So just checking, was it known when you gave the guidance, or is it something that is incremental, and therefore, we should expect for ITS you might be ending up towards the upper end of the guidance range? So that’s the question number one.
Rob Smith	Good question, Akash. Sure, we’ve not only been aware of it, we’ve been focusing on that very carefully throughout the entire year as we’ve gone back. We’ve had negotiations with over 80% of the customers in that order backlog by now, and we’ve concluded them. And those were one-on-one discussions, and it’s taken a while to do so. So we’ve been monitoring that very closely. That was in our knowledge base as we talked about our guidance for the year in September.
Akash Gupta	Thank you. And my second question is on the Slide Number 18. First of all, thank you for showing this chart on leverage, which makes it clear, the current leverage in historical context. The question I have for you is that, when we look at the numbers 3.8x and 2.3x, do you think the leverage has peaked, or do you see it might go up again in December, given the weak EBITDA? And

	maybe any comment on how long it will take before the leverage starts to come down based on your internal expectations.
Rob Smith	You know what, Akash? Let's talk about that. First of all, I think it's important to understand that the leverage ratio that is relevant for our revolving cash flow was 2.3x at the end of Q3. We don't disclose our covenants, but they are industry standard terms, and we have ample headroom. I expect, as the math goes and the numerator and denominator changes over time, as it's on a 12-month rolling basis, and so as quarters roll off and quarters roll on, the EBITDA will change, and the net working capital will change. And so it's a dynamic. We've got plenty of headroom in the covenants.
Akash Gupta	Thank you.
Gael de Bray	Yes, thanks very much. Good afternoon, everybody. The first question I have is related to SCS project execution. And thank you, again, for the details you provided at the end of the presentation on the POC accounting. But there are a number of scenarios shown there, and I was wondering which one is closer today to SCS reality, I mean on average. In terms of the timing of the cost catchups, did the adjustment come rather early or rather late? What proportion of the backlog has actually already been reset at the zero gross margin level? And is the review now fully completed?

And maybe finally, what's the -- could you provide maybe some color on the proportion of your backlog today which is running late and maybe by how many quarters on average?

Rob Smith

Yes, I think it's a very reasonable question, Gael. And I appreciate that you appreciate me putting those examples there. The portfolio was rather mature in execution, and I think that's an important part of the understanding.

Let's say, let me address it with less than 10% of our order backlog reflects a loss-making project, and the low and the loss-making projects will roll off of the backlog with declining impact over the next six quarters.

Much of the adjustment in the third quarter was due to quite a few of the projects being rather mature in their execution, and therefore, at high levels of percentage of completion and therefore significant catchup costs in the third quarter. And as I say, with decreasing impact, these low and 0% projects will roll off primarily over the next six quarters.

Gael de Bray

Okay. Understood. And do you confirm that you've now been in a position to review 100% of the backlog?

Rob Smith

I confirm that was a full and fair assessment of the project portfolio, and we do this regularly, and it reflects our very best view.

Gael de Bray

Okay. Okay. Thanks. That's great. I had a second question on IT&S. Could you give us some color on the exit rate in terms of IT&S orders and volume? Is the 53K level that we saw in Q3

	normalized enough now you think, or do you foresee a further deterioration in Q4?
Rob Smith	I'm sorry, Gael. Do you mind saying that again? I missed what you said, the what rate? Say that again, please.
Gael de Bray	I was hoping to get a bit of color on what's the exit rate in October in terms of the IT&S orders in volume. I saw that, in Q3, you had 53,000 trucks in new orders and so, obviously, significantly down on a sequential basis, but do you consider the 53K level as being normalized already, or do you expect to see some further decline in Q4?
Rob Smith	Okay. I'm with you. And on a unit basis, our expectation this whole year was that the market would finish this year below last year's record levels. And you'll recall it started out very strong and very fast the first part of this year. And so we see over the course of this full second half a normalization to below last year's record levels. Part of that was Q3, and part of that'll be in Q4, as you rightly point out.
Gael de Bray	Okay. Thanks very much.
Martin Wilkie	Yes, thank you. Good afternoon. It's Martin from Citi. A couple of questions. The first one on Supply Chain Solutions, you've kindly given a sense of completed examples. But just to clarify, none of the contracts actually went to loss making at the gross margin level. There's no big provisions or contracts that could be a big drag on cash next year. Effectively, I obviously understand there's a margin drag as these contracts are all over, but as we think about the cash flow from those contracts into next year, we're not expecting some major negative on cash. Thank you.

Rob Smith: Yeah, I just mentioned that, Martin. Less than 10% of our order backlog were loss-making projects, and of course, there are provisions in place for those.

Martin Wilkie: Yes, but -- and those provisions will be coming off next year. Just to understand as we try to build how we might think about your financials into ’23, the realization of those provisions would be a 2023 event.

Rob Smith: Well, look, as I said, we expect that that, first of all, less than 10% were loss making in the order backlog and that the reduced margin and low margin or the lower margin projects coming from the adjustment in Q3 and the zero margin projects will roll off with decreasing impact over the next six quarters.

Martin Wilkie: Okay. Thank you.

Rob Smith: Maybe you’re asking about the provision, too. It was a mid-double-digit provision.

Martin Wilkie: Okay. That’s great.

Rob Smith: And it’ll be consumed in ’23.

Martin Wilkie: Great. Thank you. And then an unrelated question, obviously, we’re moving into much higher interest rate environments. And when we look at your leasing business, it’s always been a very well-run business over time.

How are you and your lease partners thinking about rising rates? And given that your customers are already accepting higher

	prices to reflect raw materials and all the other costs and now with the higher interest rates as well, is there a point where the combination of the two things together is causing demand destruction, or just to really appreciate to hear how the industry's thinking about being able to deal with higher interest rates on the leasing side of the business.
Rob Smith	Sure. That's a good question. And what's interesting about the lease -- first of all, the lease business has quite a few good elements to it. Over half of our new truck business go out on leases. As it goes out on a lease, it goes out with a service contract. Because it has those, we're able to get those back for a second and third life for that truck. And so the leasing is good business for us.
	What I think it's important to understand, too, is it's about a total cost of ownership calculation. And it's rather insensitive to the interest rate. Why? Because the interest rate is the lowest factor in the monthly cost to the customers. It's about the original price of the machine. It's about the service contract. It's about the residual value of the machine. And then below all of that comes the impact of the interest rate. So it's rather insensitive to that.
Martin Wilkie	Okay. That's helpful. Thank you.
Richard Schramm	Yes, good afternoon. Two quick ones, one concerning the effect you mentioned in connection with net financial expenses, where you said there was a favorable development here of this fair value of interest rates. Could you specify this effect? And should we take this as a one-off, or is this more a sustainable one also appearing in the next quarters? That would be my first question.

Rob Smith

That's a bit nitty-gritty, Richard. My suggestion is you get offline with our IR team. They'd be more than happy to help you with that.

Richard Schramm

Okay. Thanks. And just the second question, on the working capital, just as a confirmation, you mentioned that you have built up some safety buffer to safeguard production. So should we assume that all the increase we are seeing here in working capital was voluntarily, or was there also kind of involuntary expansion due to delay in deliveries which hindered you to execute your projects, for example?

Rob Smith

That's the right understanding, Richard. The net working capital buildup has different elements in our different businesses. In our ITS business, our Industrial Truck and Service business, the buildup of unfinished trucks that were waiting 1 or 2 parts before they could be completed got to as high as 12,200 at the end of the second quarter. We've been able to reduce that to below 8,000 by the end of the third quarter. And as I say, we're working to drive it down further very consequently during the rest of this year.

So there's work on getting the working capital down and ITS along those lines, and the material availability of not getting the last part you need to finish the truck has that kind of an impact in ITS.

On the Supply Chain Solutions side, if you don't get the final component to be able to finish a step in the installation process, you can't invoice the milestone. And as the material availability has been quite volatile, we have projects that were just about to finish a milestone and just about to get there, expecting some critical material would arrive, didn't arrive. It postponed the ability to install that, complete the milestone, and make the invoices. So you see contract liabilities decreasing there.

And as we are able to get more material onsite and critical material, we can complete a milestone and invoice it, and that's how you drive down the working capital in Supply Chain Solutions.

In addition, as we secure projects and starts, we get advanced payments. And so those two are the -- that's the way you drive working capital in Supply Chain Solutions.

What I'd point out to you is, historically and regularly, in normal conditions, Supply Chain Solutions works at negative working capital, and we expect over time to get back in that area.

Richard Schramm — And just a quick follow up, is the supply situation improving, or is it just stable? What's the trend recently?

Rob Smith — No, it's quite difficult out there. And the environment is becoming more dynamic with energy and gas shortages and the geopolitical climate. So I expect the volatility in the market remains through next year. And we're making our plans for next year based on that, those assumptions.

Richard Schramm — Thank you.

Nicholas Green — Thank you, Rob. Thank you for taking my question. Nick Green from Bernstein. As Gael mentioned, the percentage of completion charts on Slide 27, 28, they're very helpful. You mentioned, Rob, that 10% was marked at zero margin, but of course, only 1 of the 5 examples in those two slides is actually marked to zero profit. The others have profit. It's just a much smaller amount of profit than originally expected.

So can I ask the questions again to you then that, when you made the September announcement, was that reflecting the 10% projects are actually marked to zero, or did it also include other projects which were marked down but just not at zero, in which case, can you tell us the new percentage of how much of the order book was marked down, please?

Rob Smith

So, Nick, clearly, the third quarter adjustment included projects that went onerous, and that was less than 10% of the backlog, and it clearly included the increased cost to completion of finishing the rest of the projects in the portfolio or other projects in the portfolio, so included both kinds, of course.

Nicholas Green

Okay. So you did take down write-down on non-onerous but not as high profit as expected. Can you roughly tell us --

Rob Smith

But of course, that's the statement I'm making about the onerous projects that are less than 10% of the order book and the low-margin projects will roll off with decreasing impact over the next six quarters.

Nicholas Green

Can you give us a sense of that blended margin profile over 2023 and 2024?

Rob Smith

No.

Nicholas Green

Okay. A third one or final question then. Experience suggests that, when you have a large lump sum project that's been marked to zero at less than 50% complete, there's a pretty high probability of it suffering further cost overruns, maybe further write-downs, maybe further profit warnings.

I believe you had said in the last conference call that some of the big projects were less than 50% complete that were taken as onerous projects. So with this in mind, how would you like us and investors to assess the risk of a future profit warning from those problem projects, or rather more constructively, what additional disclosure can you give us to help us make that assessment of the risk of future profit warnings?

Rob Smith

So yes, I did say that an onerous project was -- the order backlog did include onerous projects, and some of the onerous projects were early in the phase, and some were later in the phase. Some of the low margins were also later in the phase.

We take a true and fair assessment of the projects at every point in time as we assess them, and we work very hard as a project team to install and to deliver the projects in spec and as is in the project, and we're working on the material costs. And as things change over time, one of the ways you adjust the project margin and the project revenues over time is through change orders as things happen in scope.

Nicholas Green

What I mean is, can you not just share the information with us? Can you tell us the project that's in the early phase, how far through? Because it just becomes easier to track, easier to get reassurance that, actually, there isn't a future problem sitting there.

Rob Smith	No, I appreciate you working on the model, but so are we. Why don't you take this offline with our IR team? I think it's a good conversation to have with them. We expect these projects to roll off with decreasing effect over the next six quarters. And you actively manage each project, and you work on change orders on each of those projects, and you work on delivering the cost and the installation as planned. Driving the innovation in those projects, you're able to work with customers as we go through the project to make them -- to help adapt to their needs as the project's installed, and that gives scope for change orders and scope for adjustments in scope and therefore adjustments in the financials. And that's something that our project teams work very actively.
Nicholas Green	Okay. Thank you for taking the questions.
Operator	In the interest of time, we have to stop the Q&A session, and I would like to hand back to Rob Smith for closing comments. Please go ahead.
Rob Smith	Thanks, Stuart, and thanks to each of you for being a part of our call today. We appreciate your questions very much. I'm looking forward to seeing many of you when we're out and about in the next couple weeks and look forward to coming back and confirming a strong fourth quarter when we come back in the beginning of March with the fourth quarter results and talk about next year. Thanks very much. Bye.