KION GROUP AG

Q2 2023 Update Call

Conference Call Transcript

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Speakers: Rob Smith (CEO)
Christian Harm (CFO)

Rob Smith	Good afternoon, ladies and gentlemen, and welcome to our Q2 23 update call.
	For today's call, please refer to our Q2 presentation on our IR Website.
	I am pleased to share today's call with our new CFO Christian Harm. Before I hand over to Christian to introduce himself, I'd like to thank Marcus Wassenberg for the good cooperation.
	Christian, over to you.
Christian Harm	Thank you, Rob, for your kind words, and good afternoon and a very warm welcome to everyone on the phone line. I'm very pleased to co-host today's update call for KION's Q2 2023 results together with Rob.
	Actually, to me, that feels a bit like coming home because I have been in the background of these update calls many times when I was responsible for Corporate Strategy at KION Group between 2012 and 2018.
	During that time, I was also part of the team that prepared the IPO in 2013 and the acquisition of Dematic in 2016. Since 2019, I held several positions on the ITS side of our business, with my most recent role being EVP Finance of ITS EMEA, the largest operating unit within KION Group.
	Prior to that, prior to my strategy role, I was responsible for purchasing at KION as well as its former parent company Linde AG. And before that, I worked for McKinsey in Europe and for Unilever in Austria.

My educational background is finance and economics, and I was born in 1968 and grew up in Austria.

I think that covers pretty much my background. I'm looking forward to meeting all of you in person at upcoming events, and I'm handing back to Rob to kick off the Q2 presentation now.

Rob Smith

Thank you, Christian. I'll start with our key financial figures for the second quarter on page 4. Q2 was another strong quarter for the KION Group, particularly in our ITS segment. The reliability of our supply chains and our material availability has improved considerably compared to last year.

In addition, our commercial and operating measures are bearing fruit and are showing in our ITS revenues and earnings as we were able to produce on a higher level.

Supply Chain Solutions came in, in line with our expectations of a weaker first half compared to a stronger second half of this year.

Overall, group revenue of €2.8 billion increased slightly, both sequentially and year-on-year, and group adjusted EBIT increased 23% sequentially and 36% year-on-year, leading to a group adjusted EBIT margin of 6.8%.

At €124 million, free cash flow was again positive, up €283 million compared to last year and improving €19 million compared to the first quarter.

In addition to the improved operating profit, a stable net working capital compared to Q1 were the major contributing factors for this development. This allowed us to further reduce our net financial debt by €44 million in the second quarter.

Group order intake at €2.9 billion was down 24% year-on-year and increased 17% compared to the first quarter, thanks to the recovery in order intake at Supply Chain Solutions.

And based on the solid performance during the first half and our view for the remainder of this year, we've raised our full-year guidance again this morning.

Moving on to page 5, I'd like to touch a strategic highlight this quarter. KION achieved an important strategic milestone on our commitment to sustainability. In early July, we firmly committed to the Science-Based Targets initiative. With SBTi, we're adopting a well-established framework to align our operations towards the goal of the Paris Agreement on climate change, which aims to limit global temperature rise to 1.5°C.

Through SBTi, KION established the long-term climate goal of achieving net-zero greenhouse gas emissions along its entire value chain by 2050 at the latest, as well as corresponding interim targets by 2030. We're aiming to validate the targets already next year.

With this commitment, we're taking a transparent and clear path to reduce our greenhouse gas emissions, underscoring our ambition for climate-neutral business practices.

This is also an important strategic objective for our company. Sustainability is a central element of our KION strategy. The global materials handling industry has tremendous potential for climate protection, and as a leader in our industry, we have a special responsibility.

On the net-zero pathway, KION aims to achieve a linear reduction of greenhouse gas emissions through 2030 by 4.2% per annum in Scope 1 and 2 and by 2.5% per annum in Scope 3 with using 2021 as the base year. And as highlighted in our Sustainability Report 2022, which we released with our Q1 results in April, we're progressing very well.

I hand over to Christian now, who will take you through the details of our second quarter results and our guidance.

Christian Harm

So let me take you now to page 7 for the key financials of the ITS segment. Order intake of around 62,000 units improved slightly versus Q1. It was the strongest order intake over the past four quarters, both in units and in euro terms, and in line with our view on the market for the full year. Services contributed to stabilize the order intake in euro terms.

Given the strong second quarter of last year, order intake in unit terms is still down 28% year-on-year. However, the comps will start to ease as we move into the second half of this year.

Overall, the order book remained at a healthy level and supports approximately 1 year of new business revenue. The order book margin resilience improved further due to last year's price increases and price adjustment clauses now included in the order book.

Revenue reached a new quarterly record level supported by last year’s price increases as well as favorable material availability, allowing a higher production level. And service also contributed to the strong revenue level.

The adjusted EBIT and the adjusted EBIT margin improved strongly, both sequentially and year-on-year. This development was supported by positive effects from the volume and price-driven revenue growth as well as from the production efficiency gains resulting from the ongoing measures to improve our operational agility.

For the first time since the second quarter 2021, the adjusted EBIT margin exceeded the 9% mark.

I continue now on page 8, which summarizes the key financials for Supply Chain Solutions. Order intake recovered from the low prior-quarter level with the share of pureplay e-commerce having increased to 53% in the quarter. However, I would not yet interpret this development as the start of a sustainable and linear recovery in order intake.

Overall, order intake is expected to remain lumpy over the next quarters as project postponements are anticipated to continue. This is reflecting the ongoing macroeconomic uncertainty as well as higher financing costs.

As you can see on the updated market slide in the appendix of the document, our expectation for market growth with a CAGR of 9% until 2027, following a breather this year, is unchanged.

The order book continues to provide visibility for the next quarters. Approximately 70% of the order book now has price adjustment clauses.

Overall, revenue declined, as the 8% growth in the service business did not compensate for the 46% decline in the project business. And this was mainly due to lower orders from pureplay e-commerce customers in prior quarters. Currency developments also had some adverse effects on the revenue.

The adjusted EBIT and the adjusted EBIT margin is in line with expectations for a weaker first half of the year versus the second half of the year.

Now let's quickly run though the key financials for the group on page 9. The order intake reflects the normalization of demand levels in both segments following the strong performance in the prior-year quarters.

Sequentially, order intake stabilized in ITS and rebounded in SCS. The order book continues to be at high levels, providing good workload for the next quarters.

Revenue benefited from a strong ITS performance and was partially offset by softer SCS revenue. The service business continued to demonstrate resilience in both segments and reached a level of 44%.

The adjusted EBIT and the adjusted EBIT margin improved due to the strong performance in ITS. The low corporate services/consolidation line in Q2 has to be seen in conjunction with the higher level in Q1 and reflects varying timing of costs.

Page 10 shows the reconciliation from the adjusted EBITDA to group net income. Depreciation and amortization as well as the nonrecurring items and PPA items followed the usual quarterly pattern.

We saw a strong increase in net financial expenses just like in Q1 due to higher indebtedness, higher interest rates, a lower net interest result from leasing, and change in derivatives. As a result, pretax earnings increased by a lower rate than the adjusted and the reported EBIT.

One-time effects in the quarter led to a temporary increase in the tax rate, resulting in sequentially flat-ish net income of €73 million and earnings per share of €0.54 in the quarter.

Now let's move to the free cash flow statement on page 11. The free cash flow amounted to €124 million, driven by the improved EBIT and an almost unchanged net working capital compared to the first quarter. This underscores the favorable material availability and achieved production output in our ITS segment. The number of unfinished trucks remained on a similarly low level as in Q1.

Free cash flow in the quarter could have even been higher but was held back temporarily by the increase in the short-term rental business during the quarter, with the corresponding refinancing being somewhat delayed into the third quarter.

Page 12 shows the development of net financial debt and our leverage ratios. The positive free cash flow in Q2 was mainly used for the early repayment of financial debt, reducing net financial debt by €44 million compared to the end of Q1.

The RCF-relevant leverage ratio continues to improve since Q3 2022, leaving increasing headroom under the covenant.

I would like to remind you that we expect substantial improvements in our leverage ratios from Q3 2023 onwards, as the weak Q3 2022 will be eliminated from the Last-Twelve-Months EBITDA calculation.

As we continue to have two investment grade ratings, the covenant is not tested. Our focus remains to improve the leverage metrics further, to defend the investment grade ratings, as we believe they are supportive to our business model.

Including pension liabilities, the leverage on the industrial net debt also slightly improved to 2.7x at the end of the quarter.

Slide 14 lays out our updated guidance for 2023. We now expect KION Group revenue to reach at least €11.4 billion, with the adjusted EBIT reaching at least €680 million, resulting in a ROCE of at least 6%, and a free cash flow of at least €615 million. Again, the raised guidance was driven by our ITS segment.

You may be wondering why we have kept our SCS guidance unchanged, even though the first half revenue and adjusted EBIT at SCS were clearly below 50% of our full-year minimum target.

Here, you will recall that, based on the expected progression of the execution of our order book, we have guided for a weaker first half and a substantially stronger second half at the beginning of this year when we first provided our 2023 outlook. Therefore, we feel on track to achieve our full-year minimum guidance.

I would now like to hand back to Rob for our key takeaways.

Rob Smith

Thank you, Christian. Let’s turn to slide 15 for our key messages today. We raised our full-year guidance for 2023 based on the strong performance of our ITS segment this morning.

The Q2 profitability of our ITS segment was driven by favorable material availability and our commercial and operational agility measures.

In Supply Chain Solutions, the measures underway to improve agility, resilience, and profitability are well under way, and I am confident they will show effects in the coming quarters.

And KION achieved an important strategic milestone in committing to the Science-Based Targets initiative, underscoring the importance of sustainability in our strategy.

This concludes our presentation. And we’re looking forward to taking your questions. Let’s open the line, please, Emma.

Operator

Ladies and gentlemen, at this time, we will begin the question-and-answer session.

Sven Weier

Yes, thank you, and good afternoon. My first question is on the SCS order intake situation. You mentioned and referred to the lumpiness in the business and that maybe Q2 is definitely not the new normal, but on the other hand, would you kind of steer us away from expecting another low quarter like Q1? Was that also kind of an exception? That's the first one.

Rob Smith

Sure, Sven. Let's start by reminding we don't guide on order intake. We certainly comment on the market. And the market is developing in line with our expectations. There's quite a bit of uncertainty out there in the economic uncertainty and the increasing interest rates. And we're seeing that continue to affect our customers' decision making in the context of their pushing out and delaying the starting of orders on new projects. And so there is a delaying effect in the market. And we're seeing that ourselves, and that's what we see in the market.

We've got a strong order book, and that gives us very good visibility into coming quarters. And that's what I've got to share on the order intake, Sven. What's your second question, please?

Sven Weier

Second question is to the backlog of SCS. You mentioned, kindly mentioned that 70% of the book has price adjustment clauses. So I take that as 30% has not, roughly €1 billion. Are these basically all the contracts that I would call the legacy contracts that are having problems, or is that an overstatement that it's maybe -- it's not that all the contracts who have no price adjustment clauses have a problem?

Rob Smith

Sven, that would be an overly pessimistic and inaccurate assumption. Basically, the timing is simply that, from May of last year, we put the adjustment clauses in our contracts on projects that we've closed -- whose contracts we've closed since May of last year. And so it's just a roll-in timing effect on that.

And our Dematic team did a great job on making dedicated progress on closing out legacy projects. We've explained before, and it indeed was the case, we expected a substantial amount to be closed in the first half, and we expect the vast majority of those projects to be closed during the course of this year. So there's good progress on that front.

Sven Weier

Okay. Thank you, Rob.

Sebastian Growe

Yes, good afternoon, everybody. Also one question around SCS and e-commerce in particular. I heard you on the overall quarterly guidance and that you'll refrain from providing any guidance, which is fair enough. But nonetheless, I think, in the past, you were also talking about order funnel and the general sort of longer-term trajectory, where customers are taking it.

Against the backdrop of what we are seeing in the overall economic activity and potentially more question marks around consumer resilience, what is your current and latest view and discussions with customers, especially in the e-commerce part? Would you indeed think that there is a risk simply that many of the projects are pushed out by a year or so until the dust has settled ideally, or how should we simply think about that?

And in the wake of exactly that scenario, how are you planning then the business, which still I think it's fair to say is rather built up for a volume level of 3.5-plus in terms of the annual revenues probably?

Rob Smith

Sure, Sebastian. Good to hear from you this afternoon. Order intake in the market and in our SCS business market is a lumpy. You'll recall projects are getting bigger and bigger. You'll recall that projects are gaining dimension in terms of their scope and their overall size.

And customers in the uncertain macroeconomic times right now and the increasing interest rates are calculating several times. And it takes them a bit longer to make their decision to start those projects. But they are indeed starting those projects.

We were pleased to get the orders in the e-commerce vertical. We also got some good orders in other verticals in this second quarter. And our expectation of long-term market growth, 9% CAGR in the Supply Chain Solutions industry, is very solid over our strategic planning period.

I'd also tell you that we've got great confidence that e-commerce customers are going to be coming back to the market and making continued new decisions for projects, as they're digesting the amount and capacity they put in place as we helped them ramp up so significantly during the COVID times.

So we expect it'll be lumpy. We expect a 9% CAGR over time, and the e-commerce players will be coming back as they work through their capacity.

Sebastian Growe

Okay. Thanks. And then if we then move on to IT&S, obviously, I guess it's fair to say that the overall margin trajectory and the especially then improvement, sequential improvement over Q1 was indeed a positive surprise.

If one then thinks of the current situation with input costs rolling over, at least part of those when it comes to more the direct raw materials like steel prices on the hot-rolled coil side, how should we think about pricing going forward and the overall ability to defend margins at this very healthy level, if you could comment on that, please?

Rob Smith

Sure, Sebastian. We've talked a lot about the very real measures and focus we have underway in the company on our commercial and our operational agility. And with both of those levers and all the levers included in those two, that's part of driving the increasing margins and defending margins and having appropriate pricing in the market.

With our agile commercial abilities, we are able to measure costs very, very regularly and able to make appropriate and rational pricing decisions very, very regularly that help us achieve our overall profitable growth objectives.

Sebastian Growe

Okay. If I may just a very, very quick one and more personal-related one to Christian, if I may. It's early days admittedly, but nonetheless, if there's anything -- and apologies for having joined the call a little later. If there's anything which you would highlight what you would truly focus on and if there's anything that is really worth flagging in comparison with what has been done in the past and how you would do things eventually differently, I would appreciate very much any comment in this regard. Thank you.

Christian Harm

Yes, thanks, Sebastian, for asking the question. I'm now on day 14, right, in my role here, right? So it's probably a bit too early to actually say this is not a well laid-out plan of what I'm going to do differently. But the one thing is that -- in my role, is to actually make sure that we have the processes and structures in place that actually are supporting our strategic ambitions and drive the consistency and the progression that we need to have in our business.

And we will also -- I made a reference to the cash flow in the presentation, right? We will also look at and drive all the initiatives that we have put in place to firstly improve our position in that end. That was a kickstart, and I'm planning to continue the measures as they are going because they will always be right to put us in the right position.

And definitely one thing which is at the heart for myself personally is to make a very good link to the businesses as such, right, because the business performance is what is actually driving our overall performance going forward. And I think, with my personal background and my time I spent in the business, that's what I can bring to the table here.

Sebastian Growe — Sounds good. All the best for this.

George Featherstone — Hello, everyone. Thanks for taking the questions. First one would be on IT&S orders. I just wondered if there's anything you're hearing from customers that would suggest a softer unit order outlook. I think you gave high single digits for the year down than you originally expected because, obviously, things seem to be going reasonably well from a sequential standpoint.

Rob Smith — Sure, George. You've got an accurate understanding. Our expectation of the market development is indeed down high single digit this year. And our observations so far confirm that, and our experience confirms that. And it's our business and the market are developing in line with our expectations.

George Featherstone Okay. Very good. And then in terms of the backlog, obviously, it's quite extensive still, what would you characterize as the cancelation risk in that backlog if at all, or can you maybe talk to the level of --

Rob Smith Sure, George. That's a good question, too. We haven't covered that one for a while. First of all, very, very low risk on cancelations. Our machines make an integral contribution to the heart of our customers' operations and are part of their planned operations.

They're also customized for the customers' needs. And even in previous -- go back to some -- a couple very significant crises, great financial crisis. Go back to the first parts of COVID, too, very, very small cancelations we experienced either one of those times, maybe 2% or 3% cancellations in total.

So we do not have concerns on cancelations in the order book. Those are very solid.

George Featherstone And then one real quick one for Christian, if that's possible, just on free cash flow. Typical seasonality, you're kind of going against that now probably for the obvious reasons of what happened last year. But should we be expecting similarly in Q4 a very big free cash inflow to the business?

Christian Harm Yes, I think it's fair to assume that the pattern will follow this year the pattern that you have seen.

George Featherstone Okay. Great. Thank you very much.

Akash Gupta Yes, hi, good afternoon, everybody, and thanks for your time. My first one is on the mix of order intake in ITS, if you can help us

	quantify the mix between warehouse and counterbalanced trucks in the 62,300 units that you had in Q2, and how it compares against prior quarters, that's the first one.
Rob Smith	Why don't you ask your second one, Akash, while we're getting you some precise figures from the backup slides and the --
Akash Gupta	Yes, second one is more of a housekeeping question. So you have increased the guidance for net financial expense to €120 million to €150 million. And I was wondering if you can quantify how much of this is cash and how much of this is noncash. Thank you.
Christian Harm	So, Akash, I take the first question here, which was actually on the mix in the order intake on the ITS business, right, from a product perspective. I think you can actually see the details of that in the appendix of the presentation on page 21, there is the breakdown by the products by quarter. In addition to that, we have -- into the product group mix, we also have a mix, a geographical mix in the order intake, right, where we actually have a higher share of APAC in Q2 versus prior-year comparable quarter and a lower share of EMEA. So there's two overlapping mix effects, if you will. And so to your second question that was actually, what's the cash that is included in the position, right, that's in the range of 80% of the interest.
Akash Gupta	Thank you.

Gael de Bray

Good afternoon, everyone. Can I start by congratulating Christian on the new role?

My first question is on the new EBIT guidance for ITS, which implies a quarterly average EBIT of around €175 million for Q3 and Q4, so obviously down from the €202 million you've just posted for Q2.

So I guess my question is, given the degree of visibility you have from the backlog, what assumptions did you take on cost inflation to derive such a sequential deterioration in EBIT? What needs to happen for margins to come under pressure sequentially like that in the second half?

Christian Harm

So first of all, I want you to bear in mind that this is a minimum guidance that we have provided and we continue to provide here. And as we have laid out, I think we had a favorable material availability, which is the main driver here in the first half of the year. But there are still risks out there, right? And so when we updated now the guidance, we are actually balancing the risks with the opportunities.

Now you asked actually a question in terms of, what are the assumptions on the cost base that are behind that. Our assumption is actually on a more constant cost base for the second half of the year as we go.

Gael de Bray

Understood. And could you perhaps provide any color on the order dynamics so far for ITS in July?

Christian Harm	I think the order dynamic in July is a progression of actually what we have seen also in the last quarter. So it's actually continuing into July like it has ended for the second quarter.
Gael de Bray	Thank you very much. I'll get back in the line.
Alexander Hauenstein	Yes, hello. Alex Hauenstein, DZ Bank. Thanks for taking my questions. I've got two of them. First of all, I would be curious to hear about your view regarding the recent profit warnings from the chemicals industry. Do you see this as a warning signal for the whole industrial space and therefore also for KION sooner or later, or do you think it's just not that much relevant due to your diversified regional and client mix? That would be my first one. And the second is, looking at your views about pricing in ITS and also SCS going forward, are their pockets or certain elements where you see further room for realistically implementing some price lift, or are you saying, well, keeping prices stable simply was the type of thing, but at the end of the day, as some of the raw material prices are trending downwards, that's not on the agenda at all, maybe a bit of a differentiated view, if possible. Thank you.
Rob Smith	Sure, Alexander, and thanks for joining the call and the questions. Look, in terms of the chemical industries and this and that, let's talk about KION, and let's talk about KION's view. We've got a very strong order book. As a matter of fact, in both of our segments, it covers almost a full year. And that gives us very good planning certainty or planning stability for the coming quarters. And we have -- for this year, we've factored in the current macroeconomic expectations into the guidance that Christian just

talked about, with a good balanced view on risks and opportunities, providing minimum guidance.

We'll talk about next year when we get to next year. But with that visibility from the order book and with the ability to flex our cost structures should we need to, we have confidence in the guidance that we've given for the rest of this year, and we'll come back and talk about next year when it's time.

I would come back to the agile commercial and agile operational capabilities that we're working very, very hard to ingrain in our DNA here at KION in answer to your pricing question.

By checking the cost base multiple times monthly, we have an opportunity to, in real time, make rational and data based decisions on all elements of our commercials, including the pricing.

And so having that ability, we're able to with confidence operate in the market and drive our long-term profitable growth strategy in both of our segments. And those are two very important elements of how we do that. And I think you'll -- that would be the best way to understand the pricing dynamics and the way that KION approaches those.

Alexander Hauenstein Okay. Thank you. And maybe a follow up on that one, if I may. Are there any components or certain parts which are still in a kind of bottleneck situation, or is that across the board solved?

Rob Smith We talked about a better supply chain situation than previous year. We also talked about better material availability. But as Christian pointed out, there's still risks in the supply chain and still risks in the material availability. And those have different impacts, and those are still risks that we're working through.

So I would say, no, there's still risks in the supply chain, and we're still working through those. And it's not just simple clear sailing at this point in time.

Alexander Hauenstein — Okay. Thank you. And yes, have a good start, Christian.

Martin Wilkie — Afternoon. It's Martin from Citi. The first question was on China. You mentioned in your release that the Chinese economy was stronger than you expected at the start of 2023. And that's a little bit different from what we've heard from a lot of companies. Just to understand if that's referring to your business specifically or if it was a more broad macro question, just to understand the dynamics in China.

And then the second question was -- obviously, a lot of indicators, the IFOs, the PMIs are weakening, particularly in Germany, if we have a big exposure. And it's very difficult for us to sort of see the underlying level of order intake to sort of X out the big comp effects we had last year and obviously with a lot of preordering and so forth.

I know you touched upon it a little bit earlier, but just to try and understand, what is customer sentiment when you're speaking to customers? Is it sort of sequentially flat relative to where it was earlier in the year, but just to understand when you're talking to customers how they see the demand backdrop. Thank you.

Rob Smith — Sure. I think, let's pick that second one up first, as a matter of fact, Martin. We've got to aggregate all those customer conversations and customer views. And we have as we give our guidance and as we continue to revisit our views on the market.

Christian talked about it earlier. The first quarter and the second quarter are demonstrating a market that in line with our expectations. Our performance in the market is in line with that as well.

We called early on and continue to see that, vis-à-vis last year, we think the ITS market will be down high single digits versus last year.

That still leaves it at a very healthy level, as a matter of fact. If you compare that to the run rates for the 3 or 4 years prior to the COVID pandemic, it’s substantially up on that comparison.

And so even down high single digits from last year is still a healthy market. And our customer conversations aggregated confirm our view on the market and our participation in that that we’ve involved or integrated into our guidance.

If I was going to come to China, we’re all aware of the forecasts and the developments in the China market. What you might not be aware of is our participation in that. And we’ve done a very good job over the last -- last year, we started the market.

We entered into the value part of the market with a brand-new product line. We call it the KION Group counterbalance, the new KGCB product family. It’s specifically targeted for that segment of the market. And it’s being very well received, and it’s gaining market share.

So even in a -- take any market environment you want. When you're gaining market share against it, you're doing a bit better. And that's where our China business is right now.

And by the way, we're continuing to ramp that factory up, and we've got about 30 new model launches this year. And that product we're bringing into the Americas, and we're bringing that product into the European market as well, where it is being very well received also. And we expect market share traction there from that new family of products.

Martin Wilkie — Great. Thank you very much.

Christoph Doleschal — Yes, hi, good afternoon, everyone. Three questions, if I may. I know only two, but I have to ask three. So the first one is on your market outlook for ITS, where you continue to say that you see a high single-digit decline. Could you break that down into the regions, EMEA, Americas, and Asia, Asia presumably better?

The second one is, what are you planning to do in terms of financing? Because, obviously, you're paying pretty high interest rate amounts. So any plans to go for bonds or cheaper alternatives? Because, obviously, also, you had to raise the guidance for your payments there.

And last but not least, you've risen prices by 25% over the past 18 months, which was driven by the sharp cost increase, obviously. But now costs didn't rise that much. Are you not being challenged by clients on prices, saying that they want a bit of that back?

Rob Smith

Why don't I pick up a bit of that, and Christian will pick up the rest of it. We practice very rational pricing. The increases we made last year, some of them were covering significant cost increases from 2021 and the cost increases in 2022.

And having made those adjustments through the agile commercial process I was describing, we continue to make very rational decisions. And we're measuring and monitoring and making choices on our commercial decisions in the market to drive our profitable growth strategy.

I'll let Christian handle the financing one.

In general, we talk about the high single-digit market decline. That's a drop in the EMEA market. That's a drop in the North American market. And the APAC market is slightly up, as a matter of fact. And so aggregated in total, split by region, that's how you should understand or can interpret the high single-digit decline overall.

Christian Harm

Yes, so, Christoph, that's Christian here. Maybe as one follow up to Rob, if you go to page 22 of the appendix, actually, you see the regional breakdown there, with markets developing according to expectations. I think that also helps you understand the regional dynamics that we see in the order intake there.

You were asking a question in terms of, how do we look at financing and the financing options. I think we always look at the options at hand that we have. And bonds is one of them, right, but not the only one. And we will make our decisions accordingly in terms of how we actually finance ourselves going forward.

And your third one was on the price increases and the effect that the four price increases that we have done during the course of last year, how they actually affect our business. I think the order intake actually that we have and had in the first and the second quarter actually speaks the language there, right? I think we are able and were able to place the orders accordingly and feel fine and comfortable with the pricing level that we have achieved during the course of last year going forward.

Christoph Doleschal Thanks very much for that.

Jorge González Sadornil Hello. Thank you very much for taking my questions. And again, congratulations, Christian, for the new role.

I was wondering if you can tell us more about your conversations with clients for Dematic projects. Are you feeling that clients are again looking more into the efficiencies that your products are providing them, or is it still the interest rates are a concern waiting into the clients for taking the last decision?

And there, also, if, Rob, you don't mind to comment again on the momentum, because I couldn't hear before what you said. I thought that you said that it was positive, but if you can give a little bit more color, it would be very nice. Thank you.

Rob Smith Buenos dias, Jorge. So let's talk about that. That's a great opportunity to talk about our Dematic business and the SCS market.

The fundamentals of that industry are absolutely intact, the e-commerce fundamental, the labor shortages. Customers all over the world when you're talking with them are telling us, "We just simply can't get enough labor in our operations, and we need to automate to keep our growth plans going and our strategic plans going."

And there's demand people got used to in the pandemic. And all over the world, people's expectations are placing orders this morning and getting delivery this afternoon. They just want things to happen right now. And so the underlying demands for warehouse automation are very, very much intact.

Our Dematic solutions that we put in place, we're the world's leading integrator of our own and third-party technologies with a very competitive software capability and stack that puts an overall solution that's giving our customers strategic competitive advantages.

So you're asking what customers are telling me when we're speaking. They're saying, "Hey, the solutions we're putting in place together are giving us competitive advantages that I'm discussing with my analysts and my investors and my board of directors," are what C-suite customers are telling me.

So we feel very good about that the competitive advantages that our customers are realizing and continuing to drive their demand and the fundamentals underpinning that are strongly intact. And that's what's driving our 9% CAGR for the entire strategic planning period. So it's a good question.

You talked about momentum. I didn't pick up what element you're asking me to address, so if you'd precise that, I'd be happy to answer your question, Jorge.

Jorge González Sadornil: Yes, momentum in relation to the order intake, I think you made some comments on that, but my line was not working properly.

Rob Smith: Okay. Certainly, I did. What I said is the timing of the order intake is rather lumpy, Jorge. And timing of the order intake is lumpy, and customers are pushing out the start dates for starting new projects or the timing of -- the decision timing on starting new projects based on basically the macroeconomic uncertainties we've got right now and the increasing interest rates.

So that timing is pushing the start date on some projects. But overall, we see that we will continue to see those orders come in on a lumpy basis and driving the 9% CAGR that we see over our strategic planning period.

Jorge González Sadornil: Thank you very much, Rob. I don't know if you have time for another one maybe.

Rob Smith: You better hurry. Go ahead. What have you got?

Jorge González Sadornil: Okay. I was wondering if you can also comment on the profitability of the service for SCS. It's growing fast. You have been growing a lot in this business, and it's actually new. Is this going to help you to return to the margins that Dematic had in the past? What can you tell us about the profitability of service in SCS, please?

Christian Harm: I think I can say so much that we are very pleased with the profitability of the service business in Dematic. And as you can see, it has a substantial share in the revenue and actually in itself is growing very well, and that provides resilience to the business as such.

Jorge González Sadornil: Thank you very much for the color.

Philippe Lorrain: Yes, good afternoon. Philippe Lorrain here from Soc Gen. One question regarding the pricing strategy, please. Will you keep the approach of having list prices in ITS? If I understand correctly, with commercial and pricing agility, you mean that the level of prices realized would kind of fluctuate or hover around a certain baseline, depending on how input costs evolve. So maybe you can confirm that view.

Rob Smith: Sure, Philippe. You rightly understand that the basic mechanism in the ITS business is operating with list prices, published list prices.

Philippe Lorrain: Okay. But do I understand correctly that, based on these list prices, actually the applied discount or kind of price increases that you ask for your -- to your clients is going to fluctuate freely like just depending on the situation on the input cost side?

Christian Harm: Hi, Philippe. It’s Christian. Maybe I take this one. So there’s two elements to that, right? The one is -- and you have seen last year we have done four price increases, right? So it’s part of the commercial agility that we keep talking about actually is the flexibility that we reserve for ourselves to actually adapt list prices as well when we deem that to be the right thing to do.

Discounts will be different anyway depending on the size of the deal, the type of the customer, the kind of the customer relationship. That has always been the case, and that will continue to be the case.

Philippe Lorrain	Okay. But so if I understand correctly for, let's say, after the wave of inflation we've seen and based on the situation that we have right now like on the input metrics side, even if we need to take into consideration wage trends and so on at suppliers, the list prices are likely to remain like probably more stable than they were before. And then you adjust like based on what the negotiation terms are with the clients.
Christian Harm	Yes, so again, like we have explained, right, we take all factors into consideration, right? Material cost is one. Labor cost is another one. And we take them into consideration and then make our decisions and the depth as we go. I think that's at the heart of commercial agility.
Philippe Lorrain	Okay. Fine. Thank you very much.
Gael de Bray	Thanks very much for the follow up. I think you had previously indicated that -- I think that was a quarter or two ago that around 10% of SCS backlog was loss making. So I was wondering, what's the proportion now, if you could provide a bit of an update on the execution of these onerous contracts and how much is left.
Rob Smith	So, Gael, good to have you back. Yes, we did talk about that, and we talked about that in the fourth quarter last year. And we described the situation as you accurately did. We have been working that off. And what we said is, each quarter, we'd be closing more and more contracts. And as we did, the proportion of those low- and no-margin contracts would increasingly diminish over time.

And as I just described earlier in the call, we had a good amount of diligent working through those and closing those off in the first half, and we expect to do the same thing in the second half. And we expect to have the vast majority of those closed off by the end of this year.

Gael de Bray

Is there any way you could quantify a bit more how the 10% has diminished compared to the end of last year?

Rob Smith

Sure, Gael. It's lower.

Gael de Bray

Okay. Thank you.

Sven Weier

Yes, thanks for taking my follow-up questions. The first one is on SCS and seeing an increasing number of companies like Autostore and Symbotic coming up with warehouse automation as a service. I was just wondering if that is also something you are increasingly asked for by clients.

Rob Smith

Sure, Sven. That's not a major part of our customer conversations at this point in time. Maybe what I'd come back to, though, is the importance of the service business. As Christian was describing it, it's got very good margin, and it's got very good repeatability and recurrence in it.

And the exciting thing as the market leader is you have a very significant installed base. And every project that we put into the market increases that installed base. And it makes most sense with our customers for us to be doing the servicing on those installed bases.

And that all by itself is a very important recurring revenue and growing part of our business. And small players that don't have a large installed base don't have that advantage or planning capability or underlying element of their overall revenue stream and the repeatability of that.

Sven Weier

The other question I had, because you were elaborating earlier to the higher e-commerce share in Q2, I remember in the past when this one e-commerce company had a high share. I think it was a rather hardware sale rather than project business and with short lead times. Is that similar now with the higher e-commerce share, or is this a different type of e-commerce client or clients that you have now in the order mix?

Rob Smith

So, Sven, I think you're talking about fast-turning projects, and I think that the fast-turning projects need to be seen in a relative context when we talk about still some tenuousness in the material availability because, given great material availability, you're able to work through certain kind of projects quite a bit faster than others.

With interruptions in the arrival of material you've been planning on, that has a way of delaying things. And that still has an impact in the overall project execution. And so I wouldn't make those kind of comparisons that we were making before, those were in times where material availability was not a limiting factor or a continuing interruption in project execution.

And with the volatility now, we still don't have that behind us. The whole industry doesn't have that behind them at this point in time. So I think the comparison would be a little bit less accurate at this point.

Sven Weier	And the sequential increase you had this quarter was driven by a few bigger ones, I guess, right, larger contracts?
Rob Smith	Indeed, and we had called those out that they were on the horizon. And indeed, they dropped into the second quarter, and we're real pleased to have those, and that's good business.
Sven Weier	Good. Understood. Thank you, Rob.
Operator	We have no further questions. I will hand back to Mr. Rob Smith for closing remarks. Please go ahead, sir.
Rob Smith	Okay. Well, thank you, Emma, and thank all of you that have been on the call with us. We certainly appreciate your interest and appreciate you joining the call and the good interactive discussion we've had today. Christian and the IR team and I, we look forward to seeing many of you after the summer break during conferences and roadshows coming up. And we'll look forward to talking to you on this call in the third quarter. Thanks very much. Bye, bye.