Transcription

Knorr-Bremse AG - Quarterly financial report Q3/19

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PRESENTATION

00:02 Operator

Dear ladies and gentlemen, welcome to the quarterly financial report Q3 2019 of Knorr-Bremse AG. At our customer's request, this conference will be recorded. As a reminder, all participants will be in a listen-only mode. If any participant has difficulties hearing the conference, please press * followed by 0 on your telephone for operator assistance. May I now hand you over to Andreas Spitzauer, Head of Investor Relations? Please go ahead.

00:30 Andreas Spitzauer (Head of Investor Relations, Knorr-Bremse)

Thank you, Operator. Good afternoon, as well as good morning, ladies and gentlemen. My name is Andreas Spitzauer, Head of Investor Relations of Knorr-Bremse AG. I want to welcome you to Knorr-Bremse's quarterly call for the third quarter 2019 results. As a reminder, the conference call will be recorded, and is available on our homepage, www.knorr-bremse.com, in the Investor Relations sections. Please find there today's presentation and later a transcript of the call. It is now my pleasure to hand over the call to Bernd Eulitz, our new CEO of Knorr-Bremse, and Ralph Heuwing, our CFO. Please go ahead, Bernd.

01:13 Bernd Eulitz (CEO, Knorr-Bremse)

So, thank you, Andreas. Dear ladies and gentlemen, I warmly welcome you to our conference call for the third quarter results of Knorr-Bremse AG in 2019. This conference call is special for me, as you know, as I am speaking to you for the first time as the new CEO of Knorr-Bremse. Today's call is made up of three part. First, I would like to introduce myself; then, my colleague, Ralph Heuwing our CFO, will present the financial results for Q3; and, finally, we will update you on our guidance for 2019 and give you an initial view on the coming financial year. And afterwards, as always, we look forward to your questions and comments. So, let's move to chart 2, and I will happily introduce myself to you.

My name is Bernd Eulitz or, in English [different pronunciation] *Bernd Eulitz*, and Bernd is perfect in English. I am 54 years old and live in Munich with my wife and two children. I have an engineering background and studied process engineering at the Technical University of Karlsruhe, or as it's called today, the Karlsruhe Institute of Technology. For the past 15 years, I have held various management positions at the Linde Group – then Linde AG, and now Linde plc. And I am sure you know that Linde is the world market leader in technical gases and engineering, listed in New York and Frankfurt with a market cap of around EUR 100 billion. Since 2015, I was a member of the Linde AG Executive Board and Chief Operations Office for Europe, Middle East and Africa, worth roughly EUR 6 billion P&L responsibility and 20,000 employees. And I proudly look back on the results and the results development of Linde. With the closing of the Linde and Praxair merger this march, I took responsibility for the Americas, with a P&L of roughly USD 9 billion, and more than USD 5 billion actually in the U.S. itself, and again more than 20,000 employees. And, as you are aware, with the merger with put quite some effort into integrating and completing the merger integration, which we actually achieved at the end of September. Going back in time a bit more, I spent 3.5 years in Singapore, being responsible for Linde's South and East Asia Operations, with all the countries from India to South Korea. And before Linde I worked for A.T. Kearney as a consultant, and for Air Liquide in various positions.

When I look back on my professional career, I can say that it was often characterized by managing complex and international structures and being responsible for the management of large-scale projects. This is a valuable experience that I now bring to Knorr-Bremse. Knorr-Bremse is a very successful, innovative and global company, with a consistent track record and an amazing technology portfolio, as you well know. The management philosophy “Be Global, Act Local” applies well to the way we run Knorr-Bremse. On the one hand, we leverage our technology know-how around the world, between our truck business, CVS, and the rail business, RVS. And, on the other hand, it is important to us that decisions are made locally and very close to our customers. As you know, this approach is reflected in the composition of the executive board, with the two central executive board members, CFO Ralph Heuwing and myself, responsible for the group functions, overall strategy and synergies, and our two operating executive board members, Peter Laier and Jürgen Wilder, responsible for the respective truck and rail division matters. And actually, I must say, we have a well-experienced management team here. As you know, Ralph Heuwing will leave our company, which I deeply regret because I do enjoy working with him, but I am sure we will find a good successor. Also, I am grateful that Ralph is helping me for the first months to get up to speed fast and to onboard.

As the CEO and Chairman of the Executive Board, I will represent Knorr-Bremse towards our stakeholders, these being our customers, our employees, you – the investors – and the general public. My key responsibilities inside Knorr-Bremse are HR and strategy, M&A, communications, digitalization, and the coordination of our company across the divisions and regions. My focus will be on fostering a culture of high performance through teamwork, ensuring the continued development of Knorr-Bremse as the global market leader for braking and other safety-critical systems. I have now completed almost four weeks at Knorr-Bremse, and I have been able to get into quite a few meetings and a number of very exciting projects related to the mega-trends of mobility and eco-efficiency. And I must say that I found a very highly committed and technology-savvy team at Knorr-Bremse. I am actually really impressed by what I see here. And by March next year, when we present our preliminary annual results, I will have visited all our largest sites in Europe, Asia, and the U.S. Then, on March 11th, Ralph Heuwing and I will present the preliminary figures for fiscal year 2019, as well as our guidance for 2020, by this time I will be able to share my key areas of strategic focus for the coming years with you. But already I can see that our company’s strategic set-up is actually well-positioned, with ample growth opportunities. With this, I will now hand over to Ralph, to take you through the details of our quarterly results.

07:26 Ralph Heuwing (CFO, Knorr-Bremse)

Yes. Thank you, Bernd, and a very warm welcome also from my side. Before I continue with the presentation of the financial results, please allow me to briefly comment on the recent announcement that I will resign as CFO in April 2020. I did not take this decision lightly – Knorr-Bremse has been a great place to work, and a company with unique opportunities in the future – but I did make a personal decision that I might be able to add more value in different settings and in a different role in the future. The successful IPO of our company and the expanded range of responsibilities in the last few months have encouraged me in this decision. I believe that Knorr-Bremse has already opened up considerably to the capital market, and that we have initiated many projects to continue along this path. This is precisely why this company has a unique equity story to tell. The combination of the benefits and achievements of entrepreneurship over decades is now expanded by the valuable dynamic of the capital market.

What can you expect me to contribute in the upcoming months? I will be personally responsible for managing the financial closing for fiscal year 2019. I will continue to oversee a number of key projects, and especially the conversion of our ERP systems from German GAAP to IFRS, which is scheduled to take place at Easter 2020. Together with my colleagues on the Executive Board, we have jointly agreed the 2020 guidance, and until the end of March I will continue to present Knorr-Bremse to the capital market as well. And finally, and most importantly, I will of course fully support Bernd Eulitz in his introduction to Knorr-Bremse and help him take his leadership role in the best possible way. I would like to thank each of you for respecting my decision.

But now let me focus on the financial results of the third quarter. On chart 3, you can see our key highlights of the first nine months of 2019, and our key message today is: we are on track. Considering the increasing economic and political uncertainties around the world, Knorr-Bremse’s overall outperformance and resilience since the beginning of this year has been remarkable. Our results are above average, when compared to direct competitors and other segments in the industrial goods sector. We confirm the special robustness that is embedded in Knorr-Bremse’s business model, even if the order intake in a single quarter might be lower. During the first three quarters, we continued to grow profitably, and managed to push further ahead with our strategic goal to broaden and deepen our product portfolio in both rail and truck. At EUR 5.3 billion, revenues were up more than 6% compared to last year's number. The strong order book of EUR 4.4 billion and the rather long-term contracts, especially in the rail sector, provide good visibility for the coming quarters. The EBIT margin, excluding the structuring costs and the first-time application of IFRS 16, reached 18.8%, slightly below the mid-point of our full-year guidance. Earnings per share reached EUR 2.69. In order terms, this represents a decline of 7% year-on-year. However, it's important to understand that the disposal of Powertech at the end of the third quarter impacted the financial results, and therefore the earnings after tax, negatively by around EUR 80 million. Excluding this impact, earnings per share would have amounted to EUR 3.20, an increase of more than 10% over the previous year. Fortunately, today we also have some good news that will mitigate the negative EPS impact for the full year. I will come to this later. Let's move on to chart 4.

In recent months, we have succeeded in achieving important progress for Knorr-Bremse, winning important long-term contracts around the world and strengthening our sustained profitability by taking portfolio decisions and streamlining our operations. Let me elaborate a bit on three topics. We won a major order from Alstom, for the new generation of the TGV. This framework agreement for brake systems and HVACs will not only increase our order intake and sales at RVS over the next two years, but it is also a prove of our excellent market position. After all, we have succeeded in penetrating an important market segment of our main competitor in rail and gaining valuable market shares. Alstom was convinced by the global market leadership of Knorr-Bremse in the high-speed segment and our tailor-made customer solutions.

On chart 5, I will continue with two operational highlights. A milestone in recent months was the disposal of Powertech at the end of September. After a strategic review, we came to the conclusion that Knorr-Bremse is not the best owner of this business, as it has too little synergetic value to the rest of our activities. This, combined with a weak financial performance, led us to the disposal decision, which we implemented within months of taking it. Let me remind you that execution is a major success factor for Knorr-Bremse, and we demonstrated it again in this case. This measure, along with the plant closure at Wülfrath, which is progressing well, is key to reduce the burden for Knorr-Bremse while entering a more challenging market situation. In recent months, we have consciously made another decision: we are continuing to expand our U.S. capacity for air disc brakes. Why do we believe this is right decision at a time of declining order intake for North American truck OEMs? Well, after feedback from our customers, we are continuing the migration from drum brakes to air disc brakes without hesitation. As the market share is well over 50%, Knorr-Bremse in particular is benefitting from this strategic decision by our North American customers. We will not allow a market share loss in this important product area due to capacity constraints. Let's move on to chart 6.

New orders took a dip in the third quarter year over year, while the intake on Group level was down by 10.1% compared to the same period of last year, and reached EUR 1.75 billion. On an organic level, the decrease in the quarter was 13.1%. The book-to-bill rate of 0.92 in the third quarter 2019 was below last year's level, but actually slightly higher compared to the ratio in the second quarter of this year. The lion's share of this development is reflecting market dynamics in the truck division in Europe and North America. I will go into this in a bit more detail later. The rail division recorded a better development in the past quarter. As explained during the Capital Market Lunch, some projects were rolled over from Q2 to Q3. In addition, we continue to see strong overall demand for our systems and solutions, which can be seen partly in the very good order intake of the rail OEMs. Keep in mind that, although OE customers show the total multi-year volume of frame contracts in their order backlogs when they win the contract, they may only call us on an annual basis for the suppliers, like November. Accordingly, RVS's order backlog is "only" 11 months, although we have strong commitments for deliveries over several years. We are strongly convinced about the positive medium-term outlook for the group. This assessment is based on our solid backlog and the industry dynamics for the years to come. The order book, of EUR 4.4 billion at the end of September this year, was slightly higher compared to last year. And this provides visibility of 7.6 months – enough time to respond to any potential market changes that may be ahead of us, for example in the truck segment.

Let me dive deeper into our revenue development on chart 7. During the quarter, revenues on Group level grew by 2.4%, reaching EUR 1.7 billion. Organic growth contributed 0.7%. The revenue increase was supported by RVS on a comparable level in Q3/19 year over year, and in the back-up you will find all the information about the organic development of our main KPIs on a nine-month basis. The strongest regional sales book was achieved in North America, thanks also to foreign exchange rates, and also in Asia, both with a similar order of magnitude. In Europe, on the other hand, sales declined in the third quarter, reflecting the uncertainty in the region, after a strong year-on-year growth in the region over the previous two quarters.

And we continue with the development of our profitability on chart 8. EBITDA in the third quarter of 2019 grew by 6.7%, outperforming revenue growth in the same quarter significantly. Accordingly, EBITDA margin rose from 17.6% to 18.3%. The main drivers of this development were our sales growth and the conversion of profitability due to economies of scale and the success of their cost and efficiency measures. In addition, EBITDA benefited by EUR 50 million from the first-time application of IFRS 16. During the first nine months our EBITDA margin, excluding restructuring costs, reached 18.8%. With this level, we are on track to achieve our EBITDA margin guidance of 18.5%–19.5% for the full year.

Let’s turn to slide 9. The seasonal nature of the development of our cash flow is well-known to you. It is characterized by the fact that working capital typically builds up during the course of the year, and then significantly improves towards the end of the year. This, among others, is due to the fact that a number of projects are completed at the end of the year. Nevertheless, our operating cash flow and our free cash flow in Q3/19 improved significantly year-over-year, despite higher investments towards capacity expansions. In addition, we have made good progress on strengthening our operating cash flow by improving cash conversion and net working capital performance. On a year-over-year comparison, scope of days improved from 58 days in Q3 of last year to 65 days in Q3 of this year. Towards the end of 2019, we expect to continue this progress of improvement. On a nine-month basis, free cash flow reached a level of EUR 335 million. We are well on track to reach our free cash flow guidance, which is above last year’s number of EUR 402 million. Annualized operating ROCE was at 34%, on September 30th 2019, more or less unchanged compared to last year’s figure. For reasons of comparison, we have excluded the effects of Wülfrath, Powertech and IFRS 16, which together had an impact of EUR 320 basis points. The increase in CapEx reflects capacity expansion, for the continued demand for air disc brakes in North America, which I already mentioned, as well as the Munich-based site development. I will come back to this point on the next chart. In the third quarter 2019, the CapEx-to-sales ratio, excluding the IFRS 16 effects, was at 4.7%, in line with our medium-term guidance of 4%–5%.

So, in this context, let’s move on to chart 10, and onto a non-operational topic that lies immediately ahead of us. We have decided to enter a sale-and-leaseback transaction regarding real estate and, mainly, office space, at our headquarters here in Munich. We have signed a detailed term sheet with the buyer. As you know, our asset-light strategy is an important cornerstone for improving ROCE and driving our cash flow. We are constantly looking for opportunities to drive efficiency and flexibility further. In our production plans, we have already succeeded in many areas, for example, our outsourcing, highly asset-intensive production set, such as casting, forging, or pressing, to suppliers. In this specific case, we are planning to sell existing office buildings and those under construction at our Munich headquarters location, and rent them back immediately for an extended period of time. The reason for this is simple financial arithmetic. As shown on the previous chart, our operating business achieved a ROCE of more than 30%. Return on invested capital in office and lab real estate, by contrast, is in the mid-single-digit percentage range and hence rather dilutive. As you can see, this transaction represents a clear increase in value for our shareholders. Asset allocation at Knorr-Bremse follows a consistent prioritization towards our CE. What are the details of the transaction? We are selling land and office buildings for a net cash flow of EUR 200 million, which will be paid in two tranches, in 2019 and 2020–2021. This results in a booked profit of around EUR 46 million under IFRS, and actually EUR 63 million under German GAAP. The buyer, OPES, is indirectly owned by Mr. Thiele, and hence a related party. This actually represents a strategic benefit to Knorr-Bremse in terms of long-term commitment, as well as synergies with their bordering Southern real estate portfolio, especially given the particularities of the concerned properties. We sought excellent advice when selecting the buyer and negotiating the terms and conditions of the transaction, fully confirming the arm’s length nature of the agreement. We expect to sign the contract by year-end 2019. We plan to invest the proceeds, mainly in strategic and value-enhancing M&A projects, as well as R&D.

Let me continue with the divisional view on slide 11, and start with the rail division. In Q3 2019, order intake of rail vehicle systems was down by 1.6%, and on an organic level by 2.9%. In this context, let me underline a specific aspect of the rail segment. RVS is dependent on projects, which are independent of seasonality or cyclicality, but reflect the ups and downs of a diverse project portfolio. A quarterly comparison on a year-on-year basis might, therefore, sometimes be misleading. In the last quarter, we have been quite successful in winning bigger contracts, in Asia as well as in Europe. Order intake in North America, however, fell visibly, and mainly due to a lower demand in the freight sector. Please bear in mind that this sector accounts for significantly less than 5% of the global rail business, but it was a driver of our order intake in Q3. In Asia, we reported a positive development of our order intake, just like during the two previous quarters. Our book-to-bill ratio of RVS strongly rebounded to 1.04 compared to the previous quarter, and was slightly lower compared to the previous year. At the end of September 2019, the order book reached EUR 3.3 billion, which provides a visibility of almost 11 months.

Moving on to the revenue and profitability for the rail division on chart 12. In the last quarter, revenue increased by 3% to EUR 950 million. Adjusted for the disposal, M&A and FX effects, organic growth amounted to 4%. Once again, all major regions were able to show growth in the OE business in the third quarter year-over-year. In Europe, top line growth was supported predominantly by the OE business. On a sub-segment level, we have been successful in executing projects in the regional and commuter business, in light rail vehicles, for example trams, as well as in freight cars. In Asia, we realized continued momentum in our OE and our service business – the passenger segment, especially, is worth mentioning. On the other hand, we experienced headwind in the field of locomotive. In China, in particular, the higher use of trains and increasing number of high-speed trains entering the first phase of overhaul were important drivers for the increase of the aftermarket business. As a result, our aftermarket turnover has grown by almost 10% year-over-year, and now stands close to 45% of our total Chinese revenue. The second biggest revenue share derives from the metro segment in China, which is already double the size compared to high-speed. In the second quarter, turnover, through locomotives, was lower year-over-year. And then in the region of North America, revenue benefitted from good demand for the aftermarket business, mitigating lower revenues from OE. Within OE, as I said, the freight segment expectedly contributed lower revenues year-over-year. Our EBITDA showed an improvement of 6.4%, to EUR 189 million in Q3 2019, including an IFRS 16 effect of EUR 9 million. The corresponding EBITDA margin was at 20.6% for the third quarter of 2019, slightly above last year's level. After a very strong – actually, an exceptional – margin performance in the first and second quarter, we expectedly saw a lower margin in the third quarter. Cumulatively, we are very much on track towards the target that we set out to achieve for 2019.

Despite positive influences on profitability, namely the strong aftermarket performance and the efficiency improvement, it is important to emphasize that the development was impacted by some specific topics too. For example, Powertech, which we disposed only at the end of the third quarter, caused a loss of EUR 6 million in that third quarter. That was an operational loss. Additionally, Kiepe Electric's share of sales were also significantly higher year-over-year, which, along with lower margins, led to a burden on profitability. One of Kiepe Electric's sub-units is active in the general contracting business for rail customers. This business is characterized by high risk and low margins, given the relatively low engineering content. While this was margin-dilutive in the third quarter of 2019, and will likely also be in the fourth quarter of 2019, we are planning to reduce our exposure in this business significantly next year. I will come to this point in a moment.

On slide 13, I would like to continue with the development of our truck division. As we all know from recent months and quarters, our customers, the truck OEMs, recorded significant declines in their own order intake year-over-year. This development is now also leaving its mark on our CVS results. Order intake for the division was at EUR 621 million in the third quarter, which was 21% down compared with the third quarter of 2018, in normalized figures, and 26% in purely organic figures. This decrease was predominantly driven by Europe, and also the U.S. Overall, we expect truck demand in North America and Europe to be weak in the coming quarters. In the U.S., most analysts and truck OEMs expect for 2020 a truck production rate decline of 20%–30%. This shouldn't be considered as a crisis; in fact, it is exactly where we were in 2017. And that, for Knorr-Bremse, was actually a very decent year. The order book of our truck division stood EUR 1.12 billion at the end of the third quarter. This provides a visibility of 4.2 months of revenue.

Let's move on to chart 14 to explain in more detail the development of our CVS order intake on a monthly basis over the course of the year, and in comparison to 2018 and 2017. In the third quarter of last year, after the summer break, to be precise, the general demand for trucks was very strong, and the truck OEMs wanted to secure capacity at the suppliers. Accordingly, they pushed ahead and placed orders at this early stage. Twelve months later, the situation is completely different. After the summer break, our customers re-assessed the situation based on the slump in demand, and decided to correct their order flow to adjust to the market needs. So, what is our take? We do not witness any panic among the truck OEMs, as most of them only adjusted positive overreactions in previous years. This can be seen from the fact that our order intake and our book-to-bill ratio in October developed much better again. Hence the reported order intake figure for Q3, seen in this context, appears to be more dramatic than it actually might turn out to be. But let's also be clear: we do not believe that we have already seen the bottom. It is too early today to make a final assessment for the truck demand and truck production rate development in 2020.

Let's move to the next chart. CVS posted EUR 797 million in revenue in the third quarter. Compared to last year, this is an increase of 1.6%. This development was supported, too, by the first-time inclusion of Hitachi steering as of April this year, and FX. Organic revenue declined by 3.2% versus the same period of last year. With this development, our truck division once again outperformed the corresponding Q3 truck production rate (TPR) , which declined by 3.6% year-over-year. CVS was able to grow stronger than the underlying market, and was again able to gain valuable market share from our main competitor. By the way, also our aftermarket ratio, as a percentage of total revenue also picked up again. We believe that the de-stocking in our supply chain towards distributors that we experienced for a few quarters might have come to an end. In the last quarter, CVS achieved an EBITDA of EUR 130 million at an operating margin of 16.3%. This number includes an IFRS 16 effect of EUR 4 million. We are quite pleased with this development in times of a weak truck market, and regard this as a confident demonstration of our margin stability. The main driver for this positive development was the strong increase in the aftermarket share, which increased from 27% to 30% in this quarter, while the cost measures also contributed.

On chart 16, I would like to continue with the topic of TPR and those cost measures at CVS. In recent months we have seen that a number of truck OEMs established their outlook for truck production rates for next year. We have noticed that there was almost a competition of who could give an even more negative outlook. On the chart you can see the range of expectations of analysts, who expect a TPR decline of 10%–20% for Europe next year and 20%–30% for North America. CVS was affected by these declines, but to a lesser extent thanks to the aftermarket resilience and our content growth. On the cost side, we have prepared very well for different scenarios. We are currently reducing overtime, and paying close attention to the overall number of employees in our truck division. At the same time, we are acting very disciplined in terms of our overhead costs and investments. Should these efforts prove not to be sufficient, we have defind further counter-measures to safeguard our profitability. These include, amongst others, a further reduction in temporary workers and a more stringent cost management of material costs. You can be assured that protecting our profitability has top priority at Knorr-Bremse.

<u>So let’s move on to slide 17</u>. Our main message here is that, given the performance during the nine months, we confirm our revenue and our operating EBITDA margin guidance for the full year. We expect organic growth of revenue between 3.8%–6.9% in 2019. In the first nine months of 2019, we achieved 4.7%, which is well within the full year range. Including M&A activities, this should lead to EUR 6.875–7.075 billion in revenue in 2019. Based on this revenue level, we expect an operating EBITDA margin of 18.5%–19.5%, which excludes restructuring costs and as well the mentioned book profit from the sale-and-leaseback transaction, but includes the IFRS impact. In the nine months of 2019, we achieved 18.8%, again well within the range. The current market environment has certainly become more challenging and volatile in the recent months. Above all, the political environment is less predictable, and issues such as Brexit, trade wars, sanctions, are beginning to take their toll, not directly on Knorr-Bremse, but on economic activity, customer demand, and overall industry behavior. Our CVS division benefits from the resilience of its aftermarket business and increasing content per vehicle, both of which are largely independent of production rates. In addition, CVS was again able to gain market share over its main competitor. On the other hand, we monitor our customers’ development very closely. Accordingly, we have defined, tightened and, in many cases, already implemented an efficiency program to reduce the increasing cost pressure. We have been very successful in this so far. RVS, the proportionately larger and higher-margin division, has proven quite immune to the cyclical fluctuations, thanks to longer-term investment programs and initiatives in the context of climate change. In the further course of events, investments in infrastructure and rolling stock might even increase in times of a downturn, as public funds are mobilized when private funds are receding. In addition, we continuously analyze and optimize our business portfolio for maximum value creation.

I would like to end the presentation with chart 18, which gives you our first thoughts for 2020. We are currently in the planning process for next year, which will be completed over the next few weeks, but we would like to share with you our basic assumptions, our strategic focus, and the resulting first indications of financials in the year 2020. For the rail segment, we expect the passenger market to develop positively, and our aftermarket turnover to benefit from the large and solid base. From a strategic point of view, we will continue to optimize our product portfolio. In particular, we plan to ramp down the mentioned low-margin general contracting business, by annual sales of EUR 60–80 million, with no restructuring costs to be expected. According to our initial assessment, this, along with the Powertech disposal, should lead to a slight increase in RVS revenue, as well as EBITDA margin. So, RVS should be a robust and reliable performer in 2020, compensating for some of the CVS headwinds. On the CVS side, the European and North American truck market data suggest significantly lower volumes, as already mentioned. This means both of these markets should reach a TPR on a similar level to the longer-term average, for example at the 2017 level. At the same time, we assume that the correction in the aftermarket has already taken place in the last two–three quarters, and revenue this year will stabilize and contribute positively in 2020. We do not see our content story to be in any danger. Our CVS focus in 2020 will be on consistently driving forward our cost programs, while at the same time investing in our innovation agenda. Based on our current estimates, CVS revenues will drop by significantly less than truck production rates, due to a positive aftermarket business, a good development of content per vehicle, and a positive development of our market share. Based on this assumption, we expect our CVS

EBITDA margin to only decline moderately, even though we will increase our R&D spending, both as a percentage of sales and as overall figures in future growth projects. Combining the expectations for CVS and RVS, Knorr-Bremse should be able to deliver a robust group performance – exactly as you would expect us to do. Once again, these statements do not represent a guidance, but they should help you understand the mechanics that we expect to be at work in the year 2020. With this, I would like to thank you very much for your attention, and now I look forward to your questions.

Q&A

39:16 Operator

So, we will now begin our Q&A session. If you have a question for our speakers, please dial 01 on your telephone keypad now to enter the queue. Once your name has been announced, you can ask a question. If you find your question is answered before it is your turn to speak, you can dial 02 to cancel your question. If you are using speaker equipment today, please lift the handset before making your selection. One moment please for the first question.

The first question is from Ingo Schachel, of Commerzbank. Your line is now open.

39:50 Ingo Schachel (Commerzbank)

Yes, thanks very much. My first question would be on your margin in the Rail Vehicle Systems. You mentioned a lot of one-off factors – Powertech, Kiepe, and so on – and with all those phasing out, one might have thought you might have taken a more positive view on the margin expansion in 2020. Why would you not expect more margin expansion if all that slow-margin stuff is phasing out? Is it that the project mix in the last year was unsustainably stronger? Was it that there was more margin pressure in certain markets, like China? Where is it that you are seeing the underlying pressure in your core business?

40:30 Ralph Heuwing (CFO, Knorr-Bremse)

Yes, Ingo, thanks for this question. I think the starting point to answer this is actually our guidance that we released at the start of this year. We clearly said what we would expect – at the time it was 20%–21%. And if we added the IFRS 16 effects, it would be 20.8%–21.8%. So, of course, the Q2 margin, especially, was exceptionally high, which we also presented at the Capital Markets Day. And this goes back to project mix. So far, for the nine months, I think we are actually at the upper end of that guidance, so I wouldn't explain this purely with one-offs. There are always certain factors that make a quarter less comparable to the previous one, and we mentioned some of the reasons, but there are no structural issues behind that. It is the fact that, from quarter to quarter, you have a different mix of projects that are rolling in, whether it's the product mix, whether it's the geographic mix, or the customer mix. And hence the margin keeps moving within a certain bandwidth.

41:51 Ingo Schachel (Commerzbank)

Okay, thanks. And then on the timing of the sale-and-leaseback of the Munich property. Of course, it seems to be quite value accretive, but then of course it becomes more value accretive if you actually deploy the cash, so I was just wondering whether the timing of the transaction has to do with the specific bigger M&A opportunities that you see, or with the new management team maybe putting a even stronger emphasis on M&A and aiming to have deeper pockets to be ready for transactions when they come… Or is it just a pure coincidence?

42:19 Ralph Heuwing (CFO, Knorr-Bremse)

I would say that closing this before the end of 2019 does make a lot of sense, to make sure that we actually counteract some of the CapEx we are actually in the process of investing in some of the buildings, so we actually get the cash back.

But this is only to balance out, I would say, cash inflows and cash outflows. M&A is on our agenda, and we are hopeful that we can talk about transactions also in the next several quarters. As always, we are carrying a decent pipeline of opportunities and, once those are getting more concrete, you will of course hear about it.

43:13 Philippe Lorrain (Berenberg)

Also two questions from my side. The first one is if you could update us on the factoring volumes, especially against the background of very strong cash generation, and whether that was perhaps helped a bit by the decline in net working capital by more factoring volumes. That's the first. And the second one is a question on the CFO succession, whether you can share with us a view on what kind of person you are looking for. And for the new CEO starting in the company now, being in charge of HR, and one of the first big mandates he has is actually to find a successor to Mr. Heuwing.

44:03 Bernd Eulitz (CEO, Knorr-Bremse)

Okay, if you will allow me – this is Bernd – I will start with the second question. Obviously, the search for a CFO successor is handled by the supervisory board. It has already been started. Maybe it's also important to note that I am part of that review and selection process because, similar to my selection, it is very important to the supervisory board that we create a team that works together very successfully. Obviously, we are looking for somebody who has good experience in capital market relations, and in the way a company needs to be set up to perform well and interact well with the key shareholders – that is one of the main objectives. All the rest, I think, is very obvious criteria that we are looking for. I hope that answers your question as far as I can go, obviously.

45:01 Philippe Lorrain (Berenberg)

Perhaps just a follow-up on that. I understand that it's going to be likely, then, that you come up with an external candidate.

45:10 Bernd Eulitz (CEO, Knorr-Bremse)

It is likely, but please bear with us until we are able to speak more.

45:18 Philippe Lorrain (Berenberg)

Perfect. Thank you very much.

45:20 Ralph Heuwing (CFO, Knorr-Bremse)

And on your factoring question, there was no particular development. So, it was basically on a similar level as the year before. Our good cash performance was partly driven by changes in accruals. For example, the pension provisions, we had to accrue for those given the interest rate environment. And that means that a much higher portion of the profits actually came in in cash, and not because of some change or even a release of provisions.

46:10 Sven Weiher (UBS)

Thank you. Good afternoon. Two questions on the order intake and one follow-up on the RVS margin. So, on the order intake, I was just wondering… I appreciate the fact, obviously, that the order intake in rail is lumpy, but also after nine months it's only up moderately. So, I was wondering where you see the year ending on this. Should we see some acceleration in the fourth quarter? Or is the +1% to +2% also a good guide for the year as a whole? And, as far as the truck business is concerned, obviously in Q3 you had quite a monthly volatility in the orders. Do you see a more stable monthly development in the fourth quarter? In October it was down mid-single digit year-on-year – is that also a good prognosis for Q4? And then, on the margins, I was wondering what kind of total EBITDA does the EUR 130 million discontinuation has this year. Thank you.

47:10 Ralph Heuwing (CFO, Knorr-Bremse)

So, order intake in rail… I mean, you gave the keyword, which is a higher lumpiness than in truck. And, therefore, I can only say that we are on a stable and robust track. We don't expect any major deviations up or down. I think the one thing we pointed to is the U.S. freight market. It's not huge in terms of opportunities, but it has, of course, an impact. Otherwise, on our passenger side, we think that we are basically growing in line with our full-year expectations. On truck, the September observation, and partly even the July observation were – as you can see in the chart – a correction in the assessment of the market situation. And, basically, we only saw in order book what our customers had seen in their order book a few months before. Whether a single-digit reduction is the right level to expect for next year, that is the big question. And we also said there is a range. We think that -5% is a positive and optimistic outcome, and -15% is a negative outcome, but you should also watch the gap between those and the truck production rate in the market. So, you clearly see an outperformance. I think that range, of -5% to -15%, describes what we believe right now, but we are also not at the time of the guidance. In the next few months, we will watch it closely, and then come back with – I think – a much more concrete guidance for the next year.

49:08 Sven Weiher (UBS)

The question was not so much with regard to what happens next year, but more on the Q4 order intake, if you see a more stable monthly bar…

49:16 Ralph Heuwing (CFO, Knorr-Bremse)

We have been as open to you as we can, even talking about monthly figures. I think weekly figures would be a bit too much. And, so, what will be the end of November and the end of December… just bear with us. We don't know better than the general market. On the rail margin – I think that was your other question – can you repeat it again?

49:49 Sven Weiher (UBS)

Yes. You said that the sale impact of those factors is EUR 130 million in total. And I was just wondering what the total EBITDA impact of those factors is: on Powertech a negative EBITDA, on contracting probably a low EBITDA… does it look like zero? Or what should we assume?

50:10 Ralph Heuwing (CFO, Knorr-Bremse)

No. the net of those two should actually be a positive effect next year. Powertech, as we mentioned, contributed roughly minus EUR 20 million in the year 2019 and those nine months. So, once they are gone, they will not re-appear. And the

Kiepe Electric contracting business is at a rather low profitability. It's not zero, but it's rather low. So that will reduce the Powertech impact a little bit.

50:45 Sven Weiher (UBS)

And then just maybe one final follow-up on the RVS order intake. In terms of your market share, it's not like you have lost some market share in the first nine months; so it's just the lumpiness, just the timing, and it has nothing to do with the market share. Did I understand that correctly?

51:01 Ralph Heuwing (CFO, Knorr-Bremse)

Yes. If you listened closely to us, you even heard us talk about some share gains here and there. So, we do feel that we are very much on track with what you have seen from us in the past.

51:15 Sven Weiher (UBS)

Okay. Thank you.

51:24 Andreas Willy (JP Morgan)

Good afternoon, everybody. I have two questions, please. The first question is on your comment on the truck production versus your own performance in Q3. Could elaborate a little bit more on that? I think you said truck production was down 3%, but then your sales were also down 3%? Could you maybe elaborate a little bit more on that, and then maybe also make some comments on regional outperformance, either for the three months or for the year-to-date? And the second question is on the leaseback. What is the P&L impact going forward in terms of the operating cost, the rent going up?

52:05 Ralph Heuwing (CFO, Knorr-Bremse)

Let me start with the second question. We will have a higher expense of roughly EUR 10 million compared to the P&L situation beforehand. So, we are replacing, of course, depreciation with interest and rent. And, therefore, there is a gap between owning and leasing, which makes up roughly EUR 10 million. And this is also compared to the cash inflow, of roughly a 5% yield. On the truck production rate, what I said was that the market overall –but this is of course the composite of all the regions – had a negative development of 3.6%, versus our own development, which was at 3.2%. Now this is, of course, not a big gap. In the U.S., we continued to outperform in terms of our content growth by roughly 4%. In Europe, that was a little slower. In Asia, we also had a positive contribution by content growth, like in the previous quarters.

53:40 Vivek Midha (Deutsche Bank)

Hi. Thanks very much for taking my questions. Two from me, if possible. Firstly, I just wanted to follow up on the questions around rail margins in 2020. Can I just check that all of the assumptions you are talking about with margins in rail pricing are basically as normal? And secondly, just to think about Q4 margins, usually those are the strongest of the year for rail. Obviously, you have mentioned the Q2 as exceptional, but how should we think about the Q4 margins relative to H1 2019?

54:18 Ralph Heuwing (CFO, Knorr-Bremse)

Vivek, you may remember that, actually, about 12 months ago we were saying that the fourth quarter of 2018 will not be such a stellar quarter as 2017. And that was actually our expectation. So, it is not a regular that every single year we have a strong fourth quarter. It is more the project mix quarter-to-quarter. And in 2017 and, indeed, in 2018, that happened to be in the fourth quarter. In 2019, we think that happened to be in the second quarter. Otherwise, we would have a reason to talk about our margin guidance now, and we are not. So, we are confirming that the margin guidance for rail as well is what we stick to. And you might remember that I said that the general contracting business, which we are still seeing a strong contribution from in the fourth quarter of 2019, will continue to dilute our margin also in that quarter. So, it is most likely not going to be the strongest quarter of the year – to confirm that.

55:44 Lucie Carrier (Morgan Stanley)

Hi, good afternoon, gentlemen. Thanks for taking my questions. I will have two, actually. The first one is – sorry to have another follow up on the margin dynamic in rail, but – if you could comment a little bit more on the margin you are actually seeing in the backlog in RVS. How is the margin currently looking versus what you have in the P&L? Is there a risk that the mix is maybe a little bit softer as you go into the next few quarters?

56:18 Ralph Heuwing (CFO, Knorr-Bremse)

I am sorry, but I will continue repeating what I said before. We believe that the margin guidance that we showed for the full year is still true. And we will deliver within that range, which means that the current order book carries margins in that particular range. Otherwise, we would have a reason to correct that margin. The portfolio mix is rolling through. And what we can say, and that is what we mentioned with a view to 2020, is that the elimination of the Powertech business and the elimination of the general contracting business of Kiepe Electric are two specific items where we actively structured or changed the portfolio mix. Otherwise, it's just a reflection of the market need, and whether it's doors, or HVACs, or electric systems, or whether it's the business that is growing in China or North America, this mix of different projects continues to impact the margin we are going to deliver. And that, as far as we can see, remains quite stable.

57:46 Lucie Carrier (Morgan Stanley)

Okay. So, I guess the margin that you have now in backlog is not so impactful for the fourth quarter, considering you have about one year of visibility in the backlog. So, it's more going into next year, and what you are saying is that the margin in the backlog is currently stable as we go into next year.

58:03 Ralph Heuwing (CFO, Knorr-Bremse)

Yes. And with those elimination effects, we believe that next year should show better margin, on average, than this year.

58:14 Lucie Carrier (Morgan Stanley)

Thank you very much. My second question was around the CVS business, and specifically aftermarket sales. That was particularly strong indeed in the third quarter versus what we had seen. You think that the inventory correction has already taken place, but do you think that the low-double-digit growth that we have seen is sustainable from here on? And, if you think that is the case, what is the evidence that we are going to have some form of massive re-stock at the moment when the market is regenerating?

58:46 Ralph Heuwing (CFO, Knorr-Bremse)

The de-stocking that we have seen and maybe some re-stocking that we are seeing will balance out over time. We have seen, historically, the aftermarket grow at roughly 4% per year. And this is, I think, where it would balance out again. So, a positive contribution is, as we have said, what we expect for the year 2020. So, we think that, unless there is a major correction also in terms of economic activity, like a recession in many countries. Unless that is happening, the transportation volumes will provide the base for step-ups in repair and maintenance and so on, which is growing at a historic rate.

59:40 Lucie Carrier (Morgan Stanley)

Thank you.

59:42 Operator

As there are no further questions, I hand back to the speakers for the conclusion.

59:47 Andreas Spitzauer (Head of Investor Relations, Knorr-Bremse)

Yes. Thank you very much for your questions, and we wish you a very great Christmas time. Thanks a lot, and have a nice afternoon. Bye-bye.

59:58 Operator

Ladies and gentlemen, thank you for your attendance. This call has been concluded. You may disconnect now.