



Transcription

Knorr-Bremse Q3 2021 Results

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PRESENTATION

00:02 Operator

Dear ladies and gentlemen, welcome to the Knorr-Bremse AG conference call for the Q3 2021 financial results. 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 during the conference, please press * followed by the 0 on your telephone for operator assistance. May I now hand you over to Mr. Andreas Spitzauer, who will lead you through this conference? Please go ahead.

00:34 Andreas Spitzauer

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 conference call for the third quarter 2021 results. The conference call will be recorded and is available on our homepage, www.knorr-bremse.com, in the Investor Relations section. Here you can find today's presentation and later a transcript of the call. It is now my pleasure to hand over to Dr. Jan Michael Mrosik, our CEO, and Frank Markus Weber, our CFO. Please go ahead, Dr. Mrosik.

01:16 Dr. Jan Michael Mrosik

Thank you, Andreas, and a warm welcome to all of you. As usual, I will start with an overview about the highlights, and then Frank will dive deeper into the quarterly figures and our outlook, followed by the usual Q&A session. In the third quarter 2021 we continued to deliver overall a solid performance, despite an ongoing challenging environment in both industries. A special thanks to our employees for a great job maintaining business operations at such good levels. Speaking of our employees, I would like to highlight that recently we rolled out the so-called Heinz Hermann Thiele share program. We have recorded significant participation, as more than 25% of all Knorr-Bremse employees, respectively 5,300 people, took part in the program around the globe so far. Were very happy about this overwhelming trust in Knorr-Bremse shares.

We focused on the operational side. In the third quarter of 2021 Knorr-Bremse generated revenues of EUR 1.6 billion, an increase of 4% year over year. Operating EBIT margin was 13.6%, if the provisions for restructuring expenses in the US are excluded for the rail/freight unit. Margin increased by 90 basis points year over year. The truck division contributed a revenue increase of 10% and the operating EBIT margin to 180 basis points, to 10.8%. After several extraordinary quarters, we saw the expected decrease in order intake and revenues. Nevertheless, CVS performed very well despite the increasing challenges regarding the supply situation for the whole truck market. RVS posted a revenue decrease of 2% year over year, driven as before by postponements of orders due to lowered rail traffic caused by the pandemic. Operating EBIT margin came in at 17.6%, a slight decrease by 20 basis points. The strong order book of EUR 5 billion provides high visibility for the expected development of revenues in the upcoming quarters. Based on the overall good results in the first nine months of 2021, we confirm our guidance for full year 2021, and are able to narrow the ranges and we'll go more into detail on this during the presentation.

Let's have a look at the recent market situation in rail and truck on Chart No. 3. After being already affected last year by less rail traffic rail markets this year are continuously burdened by the pandemic, and the recovery has been slower so far than expected. Market fundamentals are, however, fully intact, echoed by rail operators. The long-term growth drivers remain attractive, but we saw ongoing shifts of projects both in OE and aftermarket. Nevertheless, we do not have to record any cancellations. Rail OEMs which recorded solid order intakes recently are now in their design phases. Expect that orders will hit us step by step gradually in the quarters ahead. Lead times during COVID are prolonged from originally 6 to 12 months to 12 to 18 months now. Ongoing lower rail traffic and fewer trains on tracks due to COVID still affect the



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aftermarket business too. Overall, we observe increasing ridership levels being linked to decreasing infection numbers, but normalization will take time. Overall, the RVS team is working hard to get the most out of the recovery.

On the truck side, underlying demand continued to be strong, and utilization rates of trucks remain on high levels due to high global freight and transportation needs. Despite the tense supply situation, especially with semiconductors, the CVS team has well managed the crisis so far. Several production cuts and plant shutdowns at the OEM level caused by these supply issues have never negatively affected truck production rates. The Chinese truck market, as expected, recorded a decline of truck production rate due to the introduction of CN6 in July.

Move to Chart No. 4 now, please. All 2021 is another COVID year for rail, but we believe the industry will return to its growth path again when the pandemic is more under control. Promising long-term growth drivers of the rail industry are unchanged. Our strong market position and long-term customer relationships will support RVS's future development. Rail remains the most eco-friendly mass transportation system. It is an integral part of reaching climate goals, which underlines the importance of our markets. And we are very proud that at Knorr-Bremse we can make a significant contribution to sustainable global transportation and mobility. On the truck side, we expect that supply shortages will remain well into 2022, but robust underlying demand for trucks will continue for some time too, supporting our OE and aftermarket business. The production of semiconductors has not improved yet. Distributors' inventory levels have deteriorated, which is why we expect the situation to remain tense in 2022, too. Despite the strong task force team in place, which is doing a great job, we are also expecting higher input costs in the future. Nevertheless, CVS's strong market position will enable us to forward some costs increases. Truck production rates for 2021 will depend predominantly on the development on the supply side. However, market research companies expect significant increases in Europe and North America overall in 2021. With this, I hand over to Frank.

08:21 Frank Markus Weber

Thank you, Jan, and a warm welcome from my side as well. Thanks for joining us today. Let's have a look at our numbers of the first nine months in 2021 on Page 5. Despite challenging market conditions globally, still caused by the pandemic and the supply chain shortages, Knorr-Bremse's overall performance and resilience was characterized once more by strong financials. During the first nine months of '21, revenues came in above EUR 5 billion, which is 9% higher year over year. Operating EBIT margin reached 14.2% and increased significantly by 130 basis points year over year. The free cash flow of EUR 297 million was EUR 130 million stronger than last year and led to a cash conversion rate of 60%.

Let's have a look at our quarterly results on Page 6. Compared to the previous year, order intake decreased significantly to EUR 1.44 billion, while at the same time our order book grew once again by 12%, to EUR 5.01 billion. Our revenues reached EUR 1.6 billion, which was up 4% year over year, and our operating EBIT margin grew by 90 basis points to 13.6%. Free cash flow slightly improved by EUR 7 million to EUR 189 million in quarter three, resulting in a strong cash conversion rate of 126% in the quarter.

Let me dive deeper into our order intake and order book on Chart 7. Compared to the same period last year, order intake on group level decreased by 12% to EUR 1.4 billion in quarter three, solely driven by CVS due to the significant market downturn in China and the overall supply situation Jan just mentioned. Accordingly, the book-to-bill ratio was 0.9 in the last quarter. The development of the order book at the end of the third quarter was very pleasing, as it grew strongly by 12% to EUR 5.01 billion. This figure is one of the most important ones because it is the foundation of our internal utilization rate and our expected revenue development in the quarters ahead. The increase of order book was strongly supported by CVS, but RVS posted higher order book year over year as well.

Let me continue with the revenue development on Chart 8. Revenues on group level in the third quarter of '21 increased by 4% to EUR 1.59 billion. Europe continued its growth path from the past quarters and realized an increase of 8% year over year, despite CVS supply chain issues. With a revenue share of 49%, Europe still generates the largest contribution of all regions. North America was also up year over year and posted a revenue increase of 4%. The revenues in the APAC



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region, decreased solely market-driven year over year after a very strong demand, especially in the truck business in 2020 and also in the first half-year of '21.

Let me continue with the development of our profitability on Chart 9. Operating EBIT increased by 11% to EUR 216 million, while operating margin (ROS) came in at 13.6% in quarter three. This represents a solid increase of 90 basis points, predominantly benefiting from our very disciplined fixed cost management, and therefore good operating leverage despite several freight costs and semiconductor costs headwinds. We have taken out approximately EUR 3 million in non-operating restructuring expenses, resulting from the transfer of capacities from the US to Mexico, in order to improve our freight business in our rail division. On the negative side, ongoing headwinds from COVID-related costs, like higher freight costs, as well as adverse divisional margin mix has a negative impact on the profitability in the quarter. The aftermarket revenue share increased year over year by 1% to around 37, which means in absolute terms that our aftermarket business increased roughly 7% year over year to EUR 589 million in the third quarter. At the same time, also our earnings per share rose by 11% to EUR 0.91.

Let's continue on Chart 10. In the past quarters, we continued our investments in future technologies in order to foster our technology leadership. At the same time, we increased capacity where needed and invested in maintenance, always in a very disciplined manner of prioritization. Absolute CapEx therefore remained, with EUR 82 million, on a stable level versus the previous year. In relation to revenues, CapEx slightly decreased from 5.4% to 5.2%. At the end of September '21, net working capital stood at EUR 1.12 billion compared to EUR 1.18 billion a year ago. This decrease was driven by higher trade payables, which overcompensated higher inventories. Trade receivables were basically stable year over year, despite increasing revenues. As you can see, our focused net working capital management again paid off. This becomes very visible through the improved scope of days, which we improved by nearly 15% from 69.5 to 60.5 days. Utilized operating ROCE significantly improved from 22.2% to 25.3% due to this higher profitability level. Capital employed was well under control and only basically increased due to the EVAC acquisition that we have done recently.

Let me continue with our free cash flow on Chart 11. Free cash flow in quarter three amounted to EUR 189 million, which is again a strong quarterly figure, and even EUR 7 million better compared to the previous year's quarter. This good level was driven by a disciplined working capital management and better net income. In addition, stringent and focused prioritization of CapEx drove free cash flow in the last quarter, supported also by better tax results. The cash conversion rate, defined as free cash flow before M&A divided by net income, was almost flat year over year and came in at a superb 126%.

Let's move on to the divisions, starting with RVS on Slide 12. In the third quarter of '21, order intake of the rail division was at EUR 739 million, a slight increase of 2% versus previous year. The still slow recovery in order intake was purely market driven. Ongoing COVID burden on the rail market overall continuously led to postponements of projects and tenders, but strong order intakes by our customers, which are currently in their design phases, will reach RVS with a certain lead time depending on the respective KB products in scope. Therefore, we expect a much stronger order intake in the current quarter. The biggest shifts occurred in China, both in high-speed trains and Metro, in the OE as well as the aftermarket business. This is not a KB-specific topic, but impacting the Chinese rail market overall. OE business in Europe was slightly lower, while aftermarket saw an increase. North America posted a higher order intake in both the OE and aftermarket business. The book-to-bill ratio in Q3 consequently amounted to 0.9, which is a slight increase versus 0.8 a year ago. We expect RVS will gain significantly more orders in the fourth quarter of '21. As a consequence, the book-to-bill ratio of RVS should be around 1 on a full year level. The order book increased further, reaching EUR 3.45 billion, giving us a good visibility for the next year.

I will continue on Chart 13. We have mentioned many times that the rail industry does not go well with quarterly reporting. In addition, the past has shown that the rail industry is impacted by lumpy tenders throughout the year. We expect a rather strong Q4 '21 regarding our order intake. Despite quarterly volatile order intakes in the past, the order book of RVS has grown continuously over the last few years. This is the solid foundation for our quarterly positive outlook regarding revenue developments of RVS in the future. Rail OEMs recorded quite high order intake so far in '21, so we are expecting to follow these order intake schemes with a certain delay of 9 to 18 months due to the just-before-mentioned design phases. We



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are involved in many projects and have good visibility regarding the usual lead times. Therefore, we expect strong orders above EUR 1 billion for the current quarter.

Let's move on to Chart 14. In Q3, RVS recorded revenues of EUR 805 million, slightly below the previous year's level. As mentioned before, recovery takes longer than we expected, driven by the before-mentioned market dynamics. We are not concerned about this development because fundamentals are unchanged, and the rail industry thinks in terms of years and decades rather than months and quarters. We have recorded lower revenues for our OE business overall, but a slight increase in the aftermarket business in the third quarter year over year. Aftermarket share of revenue was slightly up year over year and stable quarter over quarter, at 45%. Nevertheless, the low rail traffic, as well as the ongoing stretch of maintenance cycles to normal levels in China, especially remained a burden for the aftermarket. Europe has developed on a good level both in OE, here predominantly in high-speed and in the aftermarket business. Europe continues to be our strongest, the most stable, and important rail market, with a revenue share of above 50%. Revenues in North America were slightly lower on the OE side, while our aftermarket business shows a pleasing development, driven by higher usage. Asia, the second largest revenue contributor of RVS, is still affected by the ongoing impact of the pandemic. The biggest impact once again came from China. In this market, we had to recall declining revenues, especially in the high-speed and Metro segments, which offset the positive development in the aftermarket business year over year. In the fourth quarter, we expect a clear improvement of revenues within RVS. The operating profitability of RVS was almost flat on an EBIT level year over year. Last year's profitability benefited from COVID, profitability countermeasures, as well as a good regional mix, whereas third quarter this year faced declining revenues in the margin-accretive APAC regions. Based on that effect, the operating EBIT of RVS came in at EUR 142 million in the third quarter and a margin of 17.6%.

Let us continue with the development of our truck division, on Slide 15. After some extraordinary quarters, incoming orders of CVS dropped, as expected, and amounted to EUR 697 million, which is 23% lower year over year. The drop relates to two effects: first of all, the expected downswing in the Chinese market after the introduction of CN6 in July; second, the ongoing tensions arising from the supply situation took its toll as well. Currently, market demand cannot be fully matched due to the tight supply situation. We expect demand in Europe and North America should stay strong, but will be presumably continuously impacted by supply chain issues in the quarters ahead. The order book of our truck division amounted to EUR 1.57 billion at the end of September, which is remarkably 47% higher year over year. The order book of CVS, therefore, ranges well above our pre-COVID levels. Book to bill stood at 0.89 in the past quarter.

Let's move on to Slide 16. CVS posted EUR 785 million in revenues in the third quarter '21. Compared with last year's figure, this is an increase of 10%. The share of aftermarket revenues increased from 27% to 28%, supported by the increasing demand of transportation and the need to use trucks longer due to the tense supply situation. In absolute numbers, aftermarket was up by EUR 30 million, or in relative terms 16%. In the third quarter of this year, CVS achieved an EBIT of EUR 84 million, which is significantly higher than a year ago. The EBIT margin, or return on sales, amounted to 10.8% compared to 9.0% a year ago. I would like to remind you that the operating margin for CVS is the same as the non-operating one. Besides this quite strong development, profitability was burdened again by COVID-related costs for freight and higher procurement costs for semiconductors from brokers. On the other hand, reimbursements from customers mitigated that burden to some extent. Nevertheless, these net extra costs of around EUR 20 million occurred in the third quarter of '21, as well as in the second quarter. For the full year '21, we expect that the net extra cost could reach EUR 55–60 million.

Let's turn to my second-to-last chart. On Chart 17, I would like to give you some insights on the drivers and developments which led us to narrowing our guidance for the full year '21, compared to the range given you in February for the first time, and basically also the questions I was asked in February: what could go wrong or what could help you in order to be on the bottom or the upper limit of the respective guidance that we have given there? The rail market recovery is slower than initially anticipated. As a result, revenues came in lower than expected for RVS, which was partly compensated by the strong recovery of the truck production rate. This strong market demand was never nevertheless partly offset by headwinds arising from the supply shortages for the truck market in total. Including additional revenues from the EVAC acquisition since June, we are able to narrow the top and the bottom end by the same amount. Our new revenue guidance is, therefore, between EUR 6.6 and 6.8 billion. Needless to say, these top line effects also hit the bottom line and the operating



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EBIT margin was also impacted by the slower-than-expected recovery of the rail market, which led to a lower share of the margin-accretive RVS business within the KB group, so a divisional mix effect. In addition, the revenue share of the APAC region within RVS was lower than anticipated at the beginning of the year, which drove the before-mentioned mix effect even further. Extra costs arising for freight and semiconductors from brokers couldn't have been foreseen to the full extent and could be only partly compensated by reimbursements. We initiated quite a lot of countermeasures to mitigate those headwinds early in the year that already helped to compensate, at least partially. We therefore expect the operating EBIT margin of full year '21 now to range between 13% to 13.5%.

Last but not least, let's look at our guidance in total. For the full year 2021, on group level, we confirm our guidance I have just mentioned: revenues EUR 6.6 to 6.8 billion and EBIT margin ROS ranging from 13% to 13.5%. Next year, we expect revenues to increase slightly to solidly. Based on this, the operating EBIT margin should then develop in a slightly increasing trend. These first indications for the coming year are certainly at a very early stage, taking all the vulnerability of the current market situation clearly into account. Especially, we expect the tight supply situation to continue, including related extra costs to linger on for quite some time, foremost in the truck segment. The slow recovery in the rail market should remain. In addition, we expect further inflation and R&D is expected to be intensified based on our project schedules in order to foster our technology leadership also in the future. With this, I hand over to Jan.

27:08 Dr. Jan Michael Mrosik

Thank you, Frank. Let's move to Slide 19 of the presentation. As you may already know, our virtual Capital Markets Day will take place on November 29th. At the event you can expect a confirmation of our strategy, with an update of evolutionary developments ahead. We will inform you about divisional priorities and we will give you an update of our business drivers. Last but not least, we'll talk about capital allocation and our M&A strategy, which will not be a surprise to you. In addition, we will provide our mid-term guidance. Please reach out to the Investor Relations department in case any questions related to the Capital Markets Day might arise. We are all very much looking forward to engaging with you at this event.

Let's conclude our presentation on Page No. 20. Q3 '21 was clearly impacted by COVID, but we are very confident that the megatrends in both divisions are unchanged, and they will be important drivers of shaping our future. We will provide more details at our Capital Markets Day, as just mentioned. We expect that the pandemic will be continuing for some time, but we at Knorr-Bremse feel strongly positioned in our markets and are prepared to react quickly whenever it is necessary. We confirm the guidance for fiscal year '21 and provide a positive outlook for fiscal year '22. Thank you very much for your attention. Frank and I are now looking forward to your questions.



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Q&A

29:13 Frank Markus Weber

We now can come to the first question, Operator.

29:52 Gael de-Bray

Hello? Can you hear me?

29:55 Dr. Jan Michael Mrosik

We can hear you, yes. Please go ahead.

29:57 Gaël de-Bray

Okay, so I tried my luck here. It's Gaël de-Bray from Deutsche Bank. I don't know what's going on with the operator, but anyway, I will ask my questions. I have two, if I may. The first one is on the guidance and the second one is on competition. So firstly, if I take the upper end of the full-year EBIT margin guidance, it seems to imply an EBIT margin of probably 11.6% at best, in Q4. So, it does imply a significant decline of probably around 200 bps here. So what are the main drivers for this? And based on this trajectory, what gives you confidence you can improve margins back above 13.5% next year?

And then the second question is about RVS. Are you less concerned today or more concerned than, let's say, a year ago by the insourcing strategy for braking systems that some of your customers have started to implement, in China, obviously, but also in Europe?

31:16 Frank Markus Weber

Let me maybe start, Jan, if you agree, on the first question. I mean, absolutely right. I mean, Gaël, you put it right, so to say, in regards to the first three quarters and then the residual figure for the fourth quarter. We have to take into consideration, of course, that the markets currently are very vulnerable. We are now looking at all the postponements on going from one folder to another, etc., and also now the most recent infection rates climbing up significantly again. And all that uncertainty, it gives you a little bit of glimpse into what's the underlying environment in which we are all acting as of today. So I would rather say this is what, for quarter four, is a realistic range of figures that we are having in mind. Currently, it's to a certain extent vulnerable, but I would say it's on a realistic level. And what are the major drivers of this? We have to take into consideration that we might have negative operating leverage effects coming out of revenue. We might have some mixes that will shift. So, for example, if we take the RVS business, we do have product mix developments towards the fourth quarter, where we do see less revenues on the brake side and more on the non-brake side, so a slightly negative effect in the end on the profitability side, which is basically Europe-driven, what we see there. And we also do definitely see, in times like these, we have inflationary cost increases, which we are not talking [about] too much, because it's our daily job, basically, to go for optimization measures to compensate inflation. But this is kind of an increasing effect quarter over quarter, month over month, week over week. So, that is another thing that we usually have these kinds of costs going up throughout the year. And on the CVS side, we do have the very same. We do have a negative operating leverage coming out of revenues going into the fourth quarter. And in addition, we do have a regional mix effect that is, in the end, what we expect from our fourth quarter – a rather slightly negative Europe and North America development quarter over quarter and APAC to be positive. But due to the more aggressive European and North American business, we see the



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negative regional mix effects. In addition to that, as you know, we also have announced recently in the past – it's not too much, but – a restructuring that we are doing on the rail side, on the Kiepe business, and this will also cause additional expenses in the fourth quarter that we anticipate also, with roughly EUR 10 million.

34:51 Dr. Jan Michael Mrosik

All right. Thank you, Frank. Then the second question was about competition and the potential insourcing strategy. I think we have a very good relationship with our customers and the OEs. And we've recently, also received contracts from customers that did search acquisitions. And, for example, the Citadis platform from Alstom, we received a renewal of five years as a frame contract for the future to deliver brakes into this platform. It shows that there is an ongoing commitment for the strategic partnerships in both companies. And therefore, we believe that we will also build out our market share there as well, going forward.

Secondly, if you talk about China, this is more kind of a political topic, where the localization in the five-year plan has been defined by the Chinese government. We've been seeing a localization on the brake side in the high-speed for a couple of years in a row already. And there we are strong in component delivery still, active in component deliveries and strong in the aftermarkets, where we are enjoying an installed base that will stay in the rail market and on the rail tracks for 40 years to come. And in China, there is opportunities. So we are still enjoying a strong business on the Metro side there. So our business, in the last couple of years, moved from the high-speed OE business into the aftermarket and Metro business, where we have a very decentralized decision taking on the manufacturers of components for trains. And there we have kind of a different and more resilient decision structure. In China, we have also opportunities on the HVAC and door side. And therefore, we need to always keep in mind that there's different segments or fields that behave in a different manner. And we are about to capture, obviously, these opportunities, as they present themselves.

37:26 Gaël de-Bray

Would you say that, in the longer term, they are for you now more important on the non-braking side of the RVS business, and that accordingly, there is perhaps not a lot of upside anymore to margins for RVS?

37:41 Frank Markus Weber

So first of all, the market in general is growing by 2% to 3% in rail, in the long term, and we also expect a slight acceleration after COVID has been finished, which is obviously sometime ahead still. In this braking market, we have a worldwide market share that is relatively high, and in the other businesses, HVAC and doors, our market share is by far lower. And therefore, by the nature of these markets, opportunities to grow market share are higher in the fields where the market share is not as high as today. By the way, that's why we also invested in sanitary systems with EVAC, in order to open up a new market for us, which is an attractive one. And there also we bought the market leader, but the market there is more fragmented, and therefore there's more opportunity for us to also grow our share there. Let's go to the next question.

38:50 Operator

The next question is by Akash Gupta. The line is now open.



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38:54 Akash Gupta

Hi. Good afternoon, everyone. My first question is on rail. And if you look at Q4 guidance for orders, it looks like you are suggesting Q4 rail orders could be in excess of EUR 1.1 billion. The question I have is, have you seen that kind of rebound in orders already in the first few weeks of the quarter? Or that still needs to be secured? And then if you can also provide some color on where this growth is coming from in the mix within Q4 orders? That's question number one.

39:30 Frank Markus Weber

Let me start maybe with the first part, Jan, again. As you precisely asked on the proof, so to say, of what we are saying, yeah, October came in quite good for overall Knorr-Bremse, let me state this. Usually we don't give this information, but October came in already, in one month only, with more than half of what we have had as order intake in the third quarter. So in one month alone, more than half of what we had in the third quarter. So the rail figure alone, multiplied by three, should already bring us slightly above EUR 1 billion. So, it looks good. Now, it's still a way to go in November and December, but it looks good. And I can tell you that Jürgen, Jan, and myself, we have gone through with the sales colleagues of all regions through basically all the projects that are out there on a nitty-gritty basis. That's what we're doing since months. So, we know, and our salespeople know exactly what's going on, which tenders are out there. They know exact dates when the schedule is supposed to happen. And we don't have everything under our own control, as you very much know, but we feel confident that at this point in time that, without any given distraction, this should happen.

41:03 Akash Gupta

Thank you. And my follow-up question is on-- Sorry, go on.

41:09 Dr. Jan Michael Mrosik

Just quickly on the systematics that's being applied. What we usually do is we pile up the opportunities that we have out there. Usually they are of a very lumpy nature. These are big projects, where a significant amount of order intake would come in associated to a particular project. And this is why, on the one hand side, one needs to observe this list, but if something is being pushed out – and that might be just today – then, of course, things are, seem to be totally different from a quarter perspective, but over time it averages out and then gives a sensible picture. And therefore, I would like to also highlight that, with our orders on hand, we are at a very, very high level today.

Nevertheless, to quickly also answer your question from a different perspective, we piled up the number of projects that we have ahead of us. We multiplied them with a certain probability. And that would support the number that you've just mentioned. With all the mechanics behind this, if a customer decides to move out something left or right, then of course, the effect will also come in there. This usually then doesn't mean that things are being discarded or don't happen at all. It is just then, usually, a matter of time when these when these projects are being awarded.

42:50 Frank Markus Weber

I think I we missed out on something that you asked in regards to the mix, is that right? Of this order intake? We don't see any specific region. I mean, it basically looks good so far for all the regions. And our expectation is also that all should improve, all regions should improve. Not full disclosure yet, but we have also gotten some good news yesterday, and this should help us also in November. North America looks also quite good. So I would say the regional mix is quite good in basically all aspects.



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43:34 Akash Gupta

Thank you. And my follow-up question is on 2022 guidance. If you look at real business orders, particularly in China, they have been below expectation. And we have noticed from CRRC as well, they have also highlighted that the activity in China is weaker because customers are focusing on tackling the new round of COVID waves. But if we look at 2022 outlook in rail in China, have you incorporated any pent-up demand, given China rail has been quite weak for the last two, three years? And if and when we get that pent-up demand, it could be quite substantial in terms of revenue growth and order growth that you may see in 2022.

44:22 Dr. Jan Michael Mrosik

Thank you very much for your question. Just for putting this into perspective, the usual number of high-speed trains that used to be rolled in the last couple of years in China and were put into operation was around 220. So, what happened this year is a very strong anomaly. The number of new trains went down in this very year from this number down to 82 that we expect this year to be ordered and put into operation. There's almost a decrease by 60% or +60% that we've been seeing there. On the Metro side effect was not all that strong, but also significant. We expected about 7,700 metro cars to be put into operation. We expect now that, due to COVID, this will be reduced down to +/- 7,000. So, it gives you an order of magnitude in the high-speed area really fundamental and very substantial, and on the metro side, certainly sizable. And we expect that high speed will recover, that more trains will be put into operation in 2022. On the Metro side, we expect a phase where the number of cars will be normalized, because this 7,700 level was an extremely high one that we had in the last years because of a heating up kind of mutual rollout. And now the Chinese government has decided that a certain consolidation should happen. We expect still a strong market, but normalizing out over time.

46:26 Akash Gupta

So you expect some recovery in high-speed next year in your guidance? That would be a fair assumption?

46:36 Dr. Jan Michael Mrosik

Yeah, it would be a fair assumption to be made.

46:40 Operator

The next question is by Sven Weier, UBS. The line is now open for you.

46:45 Sven Weier

Thanks for taking my questions. Good afternoon from my side. The first one is a follow-up please, to the Q4 order intake for rail, so thanks for that. I was just wondering, the difference between the 1.1 and the 1.3 you implied with the backlog guidance? Is that just a few contracts, or just one very large one that is in between that range? Or is it just a lot of smaller contracts? That's the first one, please.



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47:22 Frank Markus Weber

You're referring to the 3.6 to 3.8 that we mentioned, this remaining order book by the end-- yeah. Now, we have given actually a range. And, as I said, if you take the around 1 book-to-bill ratio that we intend to get towards here, you would end up at roughly EUR 1.2 billion. And in the range that is mentioned out of the order book, EUR 3.6 to 3.8 billion, it's a range up to 1.3, but also below 1.2. So that's just a range, given the high likelihood of postponements that we are seeing. The potential is there, but we took the midpoint.

48:23 Sven Weier

Okay, so it's not just one large contract that makes the difference between-

48:27 Dr. Jan Michael Mrosik

No, no, no. That's a list of quite a sizable number of opportunities that we have on our sales list, and they're all weighted in order to give us an average and reflect the likelihood of, first of all, getting the deal, and on the other side, this deal being booked still in a specific quarter. There's also likelihoods associated with that, according to what I said before. In order to give a reliable number range, it's necessary, and that's what we put to it.

49:06 Sven Weier

Understood Thank you. And the second question is also a follow-up on that because it looks like Q4 is obviously going to be very strong. And then you said we have the design phases of the OEMs, and you would expect a more steady flow. How should I take that? So, in 2022, does it mean we should not have such an extremely backend-loaded year like this year? Should we have a more steady improvement in rail? Or should we also brace ourselves for another extreme year like this?

49:44 Dr. Jan Michael Mrosik

So, we expect a recovery that is based on the latest order intakes that we're seeing. And then, because the OEMs got these orders, and at the end of the day, they will do the engineering work, and then they will give the subcomponents and subsystems to suppliers, it's difficult for us to assess now, going forward, the effects of corona. I think we're all getting surprised by the power of wave number four right now. And then, what I always keep on [picturing], in order to illustrate the nature of the rail business to myself, you have to consider a big bucket of water where you have a pipe running out, which has a certain diameter. And you put all the water into the big bucket. And the fuller the bucket is, the more orders in hand you have. And then there is a pipe where the water runs out with a certain speed and with a certain quantity. And this is more or less, in the rail industry, always kind of steady, unless you have delays and projects, which we to some extent now in the COVID times have, which distort the flow of the water in the pipe. But that's, I think, a very simple and good picture of how this works. And therefore, strong order intakes in one quarter do not lead to a very strong response then on the order intake side, where you would see spikes that go then steadily over time. By the way, that's the main reason why this business is so resilient, but even here now COVID takes its toll. This is the simple picture.



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51:49 Sven Weier

Thanks. And I guess it's hard to predict right, the lumpiness? So I guess I brace myself again for backend-loaded, but maybe next year we have a slightly different dynamic then. Let's see how it goes. And then – sorry – I need to finally follow up on Gaël's question on the margin implications. I heard what you said, Frank. I get it, but still, we did already have some of these challenges sequentially, from Q1 to Q2, Q2 to Q3, and yet the margin was relatively stable despite that. I was wondering, in terms of things you penciled in there, is there also things like maybe year-end R&D ramp-up or, I don't know, some extra expenses in addition to the restructuring that you've mentioned, obviously. I just think I'm still not fully satisfied with the answer to that – sorry for that.

52:41 Frank Markus Weber

No, Sven, that's why we're here. And we have even more time in two weeks to discuss on those topics. But I mean, clearly, there is also certain seasonalities that you would always have in regards to cost developments throughout the year. So you have usually on the CapEx side, the fourth quarter is always the CapEx spend quarter. You have the same run also always somehow on the R&D side, but these are not the most significant ones, I would say. EUR 10 million, like I just mentioned, for Kiepe restructuring, which is severance cost for 100 people in Germany, it's something. We have a change in the board as well. I will not tell you the figure now, but this is all stuff that is coming also in the fourth quarter, to shed even some more light on this. So, alone, these topics are EUR 14 million.

53:50 Sven Weier

Okay, understood. Thanks for the additional color. I go back in line.

53:53 Operator

The next question is by Ben Uglow, Morgan Stanley. The line is now open for you.

54:00 Ben Uglow

Good afternoon, Jan, Frank, and Andreas. Thank you for taking the questions. I've got a few. The first one was just to try to sort of calibrate the forward sales guidance with the order book. If I look at the order book, EUR 5 billion and you're up 12%, that's a pretty robust background as we move into 2022. But my interpretation, and tell me if I'm wrong, you're saying sales growth is slight to solid. So what I penciled in is 3% to 5%. So could you just talk about where the shortfall might come from? Is this because you see sort of more supply chain headwinds in CVS next year? Or are you actually thinking that there might be – dare I say it? – a little bit of a fade in the short cycle areas over the course of the year? How are you thinking between the orders and sales, please?

55:05 Dr. Jan Michael Mrosik

Ben, I'm going to start quickly, and then Frank will add a few comments from his side as well. There is, of course, currently orders on hand and new order intake on the CVS side currently being curbed in terms of turnover by the logistics challenges that we're having in there, particularly in the semiconductor field. There is more demand right now in the system than can be delivered. And sometimes there is more demand in the system than, even with a perfect supply situation with



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semiconductors, could be handled by the OE industry, which is, for example, in Europe, roughly 50,000 trucks per month. And if orders go above that, then there's a limit and there's a constraint. So that's one side.

The second side is that – and that's why I used the simple picture before when the question was asked by Sven – in the rail industry, a spike and a strong activity on the order intake side means that this order intake on the OE sides then translates into OE on the supplier side, which means the Knorr-Bremses of this world, some 12 to 18 months later. And then there might be a rollout of this program through hundreds of rail cars. And that might take five years. And then it comes in quantities of X cars per month. So that means a spike in order intake does not mean a corresponding spike on the revenue side. It just fills up our order pipeline, and then we deliver over time.

57:03 Frank Markus Weber

And if I may add one thing, just to be also and stay systematic in what we are saying and what we have said, when we did say the introduction of slight/solid/significant terminology, we said slight is something below 5%. Solid is then something between 5% and 10%. And if we say slight to solid, so it's the midpoint of those two ranges. And that midpoint would be around 5% mathematically, just to help you also resolve this discrepancy that you have been calculating, if that's helpful, I hope.

57:51 Ben Uglow

That is. Thank you. I appreciate that. Second question. In the presentation, you used a language which was a little bit stronger than usual, I think, about a burden from China aftermarket. Can you talk about what you're trying to communicate there? And in particular, what I really want to understand is, surely your aftermarket business overall, the installed base that you actually alluded to earlier, is continuing to grow. Is that not a fair assumption? So if we see OE units going down, but the aftermarket business improving, why are we not seeing a relative improvement on the margin mix?

58:41 Dr. Jan Michael Mrosik

What you're seeing right now is the specific COVID situation. So in principle, your comments about installed base and corresponding aftermarket business are right and reflect the situation quite well. On the other side, as it stands today, ridership is still low. The number of trains that are on the tracks is lower than usual and the mileage is less. And therefore, maintenance intervals are being stretched, and that leads to a situation where additional effects come on top and overshadow this installed fleet kind of mechanism.

59:42 Frank Markus Weber

Ben, in addition, to your question in regards to that effect on the mix and on the margin, if we look throughout, first of all on a group level basis, the quarters that we have had in 2020 and '21, we've always been on the group level on an aftermarket share of around 37%, 35%-ish, 36%, around that. So, no significant base change of that. Sometimes, quarter over quarter, it got a little bit better or a little bit weaker, depending on the [height?] of the OE. What needs to be said is the business, per se, is stable, and the fluctuation of the percentage basically comes from the OE within a certain quarter. So, you're right. It helps or dilutes sometimes the profitability and the margin, but the sheer amount of the aftermarket is kind of stable and should also grow given the trains in the order.



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1:00:49 Ben Uglow

Understood. And then final question, maybe I should know this, but Frank, you kindly calibrated the revenue guidance. What does “slight margin increase” actually mean? Is it 20 basis points, 50 basis points, or 100 basis points? Where do we fall in that sort of range? What are you trying to qualitatively indicate, is what I'm asking.

1:01:13 Frank Markus Weber

Well, I mean, first of all, it would be, I think, great that we all understand we said it's our first indication, going into the year 2020. So it's the best of what we can see at this point in time in regards to the future, given all those uncertainties. So it's not a guidance. We intend to give you the concrete detailed guidance in February, once we meet for the year-end closing – fact one. And then second, we said slight in regards to the margin would be up to 50 basis points. And we said solid is then 50 to 150 basis points in regards to margin.

1:02:00 Ben Uglow

I understand Thank you. So versus 13% to 13.5%, so we all understand it, from that range we're talking at the moment – and it's early days – around about a 50 basis points uptick. That's a fair assumption?

1:02:16 Frank Markus Weber

Indeed, indeed, Ben. You're right.

1:02:19 Ben Uglow

Understood. Brilliant. Thank you very much, gents.

1:02:26 Operator

The next question is by Vivek Midha, Citi. The line is now open for you.

1:02:32 Vivek Midha

Thanks very much, everyone. Good afternoon. So I had a couple of questions. And the first question is on the truck market. I was just interested in your thoughts on the midterm cycle. To what extent are you concerned that all these pushouts in the supply of trucks can maybe dampen demand and you sort of miss the upper bit of the cycle, versus potentially getting a push-out for extended cycle, despite the market historically being quite short cycle.

And secondly, just following up on the Chinese market, you touched on the China Metro market. The government's looking for some consolidation of the market. So I'm just trying to understand the drivers as well. I mean, to what extent is this impacted by the financial situation of the local governments in China? Thank you.



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1:03:31 Dr. Jan Michael Mrosik

First of all, what we are currently seeing is that in our systems, the oldest CVS OEs are usually building up over time, due to the semiconductor situation, as well as capacity constraints. Then orders are being pushed out in order to accommodate the realities and the constraints of the business. And that means that, obviously, this push-out that you have asked about and the prolongation of the cycle, moving demand into later periods, is actually happening. And therefore, we're seeing demand in later quarters coming up out of out of orders that have been postponed due to the non-ability to deliver. And indeed, this prolongation, we are seeing.

Second question on China Metro market, this market is the one that we believe is going to normalize on levels around 7,000 cars per year, so on the level that we're seeing this year. It used to be overheated in terms of the numbers, that 7,700 and the like, and this is due to assets being on the tracks already in China being optimized right now, and the focus of new projects in order to really make sure that spend is being done wisely.

1:05:27 Operator

The next question is by Philip Laurent, Berenberg. The line is now open for you.

1:05:33 Philip Laurent

Thanks. I would like to come back to your first indication for next year in terms of margin. Thanks for providing us with a first view on that it could be up like by 50 bps. I was wondering, because you don't provide anymore any view on the EBITDA guidance or EBITDA margin guidance, whether the EBITDA margin would be up to the same extent or whether we could expect, actually, the EBITDA margin to be up slightly more than that, and actually a depreciation as a percentage of sales to be up slightly more, just because you've been capitalizing some R&D costs and doing some investments in the recent past that are going to result in depreciation going up.

1:06:19 Frank Markus Weber

Thank you, Philip. Thank you so much. You're right with your conclusion. First of all, you should expect at least the same, somehow, what we as indication see for EBITDA, as well. And you're also right, given our CapEx history and the current activities and the ongoing striving of the company for innovation, excellence, etc., and with also capitalization of R&D that goes along with all that, depreciation might increase slightly over time. And therefore, you should draw the conclusion that EBITDA might be slightly a little bit better. In regards to the momentum, you are correct. That's right.

1:07:15 Operator

The next question is by Alfred Glaser, ODDO BHF. The line is now open for you.

1:07:25 Alfred Glaser

Hi. Thank you for taking my questions. I have one part on costs and the other one on 2022 outlook. On costs, could you update us on how much flowback of COVID to savings do you now expect in in 2021? And on inflation costs, how much do you think you can pass on to your customers? And how much do you have to wipe out through productivity gains and other such measures? And I will ask my question on 2022 afterwards.



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1:08:06 Dr. Jan Michael Mrosik

Okay. So first of all, I think we have had always the aim, when we were in 2020 with all those measures being taken – you remember the concrete figures; I don't think I have to repeat them – we always said that we are striving to make 25% of those COVID cost-saving measures that we implemented sustainable in the years to come. This is what we're striving for. And it looks okay that we basically achieved this. This is still the right figure to calculate with.

Second of all, on the inflation side, also, basically, nothing really changed. We have, to a large extent, basically, clauses in our contracts that enable us on the truck side to spill over the respective costs to the customers. They may sit on our P&L for quite some time. So, in the end, they do somehow, to a smaller extent, also hit our P&L. In Q2 I talked about EUR 10 to 15 million, roughly in that range. And this still holds true. So that is one thing. On the rail side, of course each and every project-- rail is a project business. So we are basically trying to charge any kind of material increases, charge it to the customer. In some businesses like New York Air Brake, for example, we also have these price sliding clauses. So it's also kind of an automatism, with a certain time delay sometimes, but similar automatism. On the other businesses, on the rail side, it's rather a project business where we follow pricing. Power, as you know, is also quite good as the market [unintelligible]. And we don't see a dramatic issue on that side, on the rail. But I also always want to make you aware, and I repeat that another category, not these raw material price increases or inflationary cost increases, is the so-called extra costs that we elaborate in detail usually. This is the EUR 55 to 60 million throughout the whole year, where we had in the second quarter some EUR 20 million net and in the third quarter again some EUR 20 million net costs in the business system. This is due to increased freight costs, container costs, e.g., due to special freight ways, like air freight at times, in order to ensure the production of our customers. It has dramatically increased semiconductor prices for semiconductors that we buy at brokers, and it also has some packaging inefficiencies on the procurement side in these times of the supply chain. They are extra, and they hit us.

1:11:30 Alfred Glaser

Thank you for these explanations. And then on 2022, I was wondering, since the business situation outlook is quite different between rail and trucks, could you give us some indications on how to split your first view on 2022 between what we should expect in rail and what we should expect in trucks, please?

1:11:57 Dr. Jan Michael Mrosik

I think, at first glance, and we will talk about that more when we meet in two weeks in regards to also what our expectations midterm are, and of course on the way to a midterm vision or target where you have to come across '22 as well, but as of today, I would see no significant deltas between the two divisions in regards to the momentum out of '21 when it comes to top line. So it's not that the one is 10 and the other is 0 in regards to revenue growth. In order to come up to a midpoint of 5, we see it in a similar range, give or take.

1:13:00 Operator

There are no further questions for the moment.

1:13:02 Dr. Jan Michael Mrosik

Thank you, operator.



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1:13:03 Andreas Spitzauer

Thank you very much for your questions. We hope you stay healthy and safe, and wish you a very, very great weekend.
Thank you and bye-bye.

1:13:12 Dr. Jan Michael Mrosik

Thank you. Bye-bye

1:13:13 Frank Markus Weber

Thank you very much, colleagues. Thank you.

1:13:18 Operator

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