Transcript of Webcast and Q&A session of Knorr-Bremse's Strategy Update

Date: July 18, 2023

Andreas Spitzauer:

Good afternoon. I hope all of you are very fine. My name is Andreas Spitzauer, head of investor relations of Knorr-Bremse, and I want to welcome you to our strategy update. Today, Marc Llistosella, our CEO, and Frank Weber, our CFO, will present the updated strategy of Knorr-Bremse, followed by a Q&A session. This event will be recorded and is available on our homepage www.ir.knorr-bremse.com. It is now my pleasure to hand over to Marc Llistosella. Please go ahead.

Marc Llistosella:

Thank you, Andreas. Ladies and gentlemen, I'd like to wish you a warm welcome also from my side and thank you for joining today's call about our strategy update "Next Level Knorr-Bremse" – introducing our "BOOST 2026" program. As promised earlier this year, today we're going to present to you where we are heading and tell you in detail how we want to achieve this. In recent months we laid out all our cards openly within the Group and had intense and productive discussions. What we're presenting to you today is an update of our corporate strategy, a road map showing the journey Knorr-Bremse is planning to take. It's not a complete reinvention, because that's not something Knorr-Bremse needs. This company already has a great foundation based on its successful past. However, we are facing major headwinds and it's clear: If we want to succeed in the future, we need to adapt. We have a clear goal: Knorr-Bremse should turn into a strong capital goods company by successfully managing a portfolio of strong assets. We have defined a target vision for the next few years and it's something that all of us at Knorr-Bremse will use as a point of reference. I noticed early on that we as Knorr-Bremse know where we stand now and what we can do. But our future path was not clear enough. The strategy update addresses exactly that. We're going to concentrate on our strengths and develop them further. We want to become significantly faster and more efficient. In the next 45 minutes, I'll explain to you an analysis of the status quo, what we're aiming for, and what concrete measures will support our future development. Our CFO Frank Weber will take you a little deeper into the financials and then we are happy to answer your questions. So, let's get started.

(Slide 2) Knorr-Bremse looks back at an exceptional history of growth. If you look at the figures of the past 10 years, you see the success story I am talking about. This laid a very strong foundation. Those were the glory days when our company and revenues moved in only one direction: onward and upward. But to be clear: Back then, we had a very favorable market environment, namely the China boom coupled with our technological leadership made KB to what it currently is: a very strong global market and innovation leader in its focused markets. Our installed base as well as our strong positioning in the aftermarket still help us to defend this position.

(Slide 3) However, we all know that times have changed in the past years and the pre-IPO success as well as some promises could not always be kept. Let me be very clear here: This is not at all what we expect of ourselves! And truth is, I know that some of you have partially lost trust in us over the past years. I do understand that. So, one of our top priorities is to rebuild trust. That´s why the management team and I did a very honest review of where we stand, when I started my new position in January. A successful way forward requires clarity in analysis and honesty in reflection - what is going well, what can we do better? There must be no prohibitions on thinking. We all know that growth, margins and cash conversion have decreased. This is on the one hand because of many external challenges that did not work in our favor, for example COVID, the Russian war on Ukraine, inflation, the economic development in China or the on-going trend of de-globalization. On the other hand, and that´s the good news: Knorr-Bremse as an organization has some potential for growth and improvement by itself. For instance, we will simplify our complex legal entity structure, to get even more efficient and faster when we talk about decision making.

(Slide 4) As I said at the beginning, in recent months we laid out all our cards openly within the Group. In addition, we had over 100 contacts with you and many other capital market players. And be aware, we listened to you and we hear you when you say that there are certain things we need to address. Yes, Knorr-Bremse is missing new areas of growth, we had an unclear M&A strategy and yes, we have to look out for a compensation of our Russian business – just to name a few challenges. You see, we know exactly, what challenges we are facing today. And those challenges are being addressed. We already started doing our homework and I think this has already been positively acknowledged but of course there is way to go. But let there be no doubt: We walk the talk. We do what we say. So, let me give you some concrete examples: Our group wide Profit and Cash Protection program PCPP is on-going and helps us to reduce the cost burden. Moreover, we did an extensive portfolio review and we increased our efforts on active portfolio management. To reduce the complexity of the entire organization we already closed 20 legal entities and will continue to do so. All this shows that we are already well underway to “clean the house”.

(Slide 5) This brings me to the next chart. I want to emphasize again, because it is so important for all of us: The main focus of all what we are doing now and in the future is on margin improvement. “Profitability is king!” We know that the “good old days” are over and now it is time to bring Knorr-Bremse to the “Next Level”. So we have introduced a comprehensive program called “BOOST 2026” – I will talk about that in more detail on the next page. I think with some housekeeping measures, we will be able to bend the curve. Brownfield initiatives have been defined and kicked off. When I say Brownfield, I mean on the one hand strengthen our existing core business (for example with active portfolio management). But also to grow the core, with product differentiation and incremental growth opportunities. On top of that, we will also initiate several Greenfield topics. This will be the “cherry on the top”, the expansion. Here we plan to expand the Knorr-Bremse business which enables us to boost our profitability. Examples for Greenfield will be the exploration of adjacent business fields (new markets) but also adding new products and components with high future potential to our offering. You can expect an update on this around February 2024. For now, I will focus on what is ahead of us until 2026 and give you more flavor of our “Next Level KB” strategy update.

(Slide 6) To reach the next level, we have come up with BOOST - a comprehensive program with clear responsibilities and a broad set of initiatives. The program is split into the elements “Products, People and Processes”, which I am convinced are the main building blocks for success. As you can see, while some initiatives have already been started, others are in the pipeline. I will use the next minutes to dive deeper into our current focus topics.

(Slide 7) Let´s start with the most important topic, from my point of view: the Cultural change.
This is at the center of our program and a topic that is very important to me. A good corporate culture that allows for open dialogue, positive failure and learning culture that constantly re-assesses the status quo is key to success. It is one of my personal priorities to implement at Knorr-Bremse a real "failure culture" - "Fail fast – fail early". Why is that so essential? Because without a real failure culture, there will be no innovations. We need an open and entrepreneurial mindset in this company. It is all about team, commitment, responsibility and execution. This lays the foundation to bring all our initiatives to life.

(Slide 8) One topic that you are all interested in is China, especially regarding the rail business. China has been one of the most important markets for us and be sure, it will continue to be. But the well-known "China party" is over and we face a "New Normal" now. Luckily, we profit from a strong installed base and the aftermarket shows some recovery as well. We need to be honest and acknowledge that we will not be able to continue the old growth path. Even though there are some challenges, we can confirm our revenue outlook which we provided during the presentation on our Q2 2022 results. We are close to the bottom regarding revenues. To defend our position, we have defined strategic priorities such as increasing our supply chain resilience, de-risking business systems and improving our cost base. Our superior technology and strong, long-term customer relationships will help us to be successful in China.

(Slide 9) In truck, we see the Chinese market development rather supportive for CVS. As you can see, the truck market is forecasted to grow by 9% p.a. until 2026E, which we expect to outperform with our CVS business via Content per Vehicle growth. Key drivers for the outperformance are especially our utilization of the rising content per vehicle in China, our strong cooperations (e.g., 3 long-term joint ventures in place), and our very experienced local management team.

(Slide 10) As just touched upon, content per vehicle will remain a major growth driver for CVS, not only in China, but in general. And here comes the main message: The trend in the market shows that especially in Asia and Western Europe there is growth potential. Medium-term, megatrends such as e-mobility and autonomous driving will be quite supportive to the content within a truck. This will also be positive for our truck division. Historically, Asia was relatively slower in adapting safety features than other regions. Picking up on the advancement will further catalyze growth in Asia. In North America, KB has adapted well to the technological trends in Trucks, which is why we are already at a high level of CpV. All in all, Knorr Bremse will especially benefit from Asian CpV growth and is expected to increase its CpV above 4% relatively independent from the truck production rates.

(Slide 11) In order to improve our margins, we took a closer look at our bottom line and key indicators. We know that in the past, major efficiency indicators such as revenue or EBIT/Headcount have been stagnating at best, leaving room for improvement. With various efficiency measures, we are on a good way to increase profitability. Let me highlight a few things: In our divisions, we already started various savings initiatives, e.g., material cost savings, indirect purchasing and operational efficiencies with large savings potentials. Moreover, we plan the Extension of functional & regional focus from a Shared Service Center to Advanced Global Business Services. In terms of process harmonization and improvement, we have started a pilot with data specialist Celonis. Main improvements will be realized along: labor productivity (through automation…), Supply Reliability (i.e., late deliveries) and working capital (early deliveries). We did this for the Purchase-to-Pay process, but have other processes in the pipeline as well. I already mentioned the legal entity reduction that tackles our historically grown complexity. We have already reduced legal entities by ~15% and currently stand at 126. Our goal is to reduce this number to lower 100. For all these measures we apply our proven PCPP approach, including monthly reviews, regular reporting on implementation status and constant re-iteration of measures.

(Slide 12) However, we see that efficiency measures alone cannot tackle our recent margin dilution. As already mentioned in our last earnings call, we have conducted a thorough portfolio review. Not all our acquisitions and businesses have performed in the past. And as part of our new positive failure and learning culture, we now acknowledge that KB is not always the best owner for some of its businesses. We have identified first targets that do not fulfill our requirements any longer and that we plan to either fix or sell. Whether we want to give these assets another chance or whether we divest them, is based on a holistic review, including their strategic fit, technological differentiation, and market positions in addition to financial performance / future potential. These assets made up €1.4bn in revenues in 2022, and until 2026 we expect a boost to our profit margin by roughly 200bps.

(Slide 13) Now, coming to renewing our innovation power. Let me take a moment at this slide to tell you about where we currently see our next level in terms of technologies and products. For both of our divisions, we want to expand our position as a product and system provider. Cloud, connectivity, digitalization and ecosystem are keywords in which direction we want to further strengthen the businesses of our truck and rail divisions. In RVS and CVS this essentially means further adapting our components to megatrends such as e-mobility, digitalization and ultimately connecting our parts to aftermarket ecosystems, where monitoring becomes continuous, and maintenance becomes predictive. Stay tuned for more information on this by early next year.

(Slide 14) Coming from graphical pictures and visions to implementation: the basis for these aspirations is laid by our strong R&D base. The foundation and future focus will lay the path for four different types of product innovation. First, we have product roll-over. An example from trucks is EPS, electric power steering, which can save 0.3L of fuel per 100km. We have already signed 2 global Truck builder contracts. Secondly, an example from rail for a product upgrade is condition monitoring, which I will talk about in more detail later. However, we are also continuously inventing new products, such as our digital automatic coupler in rail. A deep dive will also follow. Lastly, scope increases will broaden the horizon for our products and systems, and we are specifically envisioning an aftermarket ecosystem. Cojali is a good example for a first step into this direction. We took a majority in this company in 2022. In general, I can tell you that we introduced a rigorous tracking mechanism to make sure we reach a high R&D efficiency. In both of our divisions, the innovation cycles for a product are tracked along the S curve of a product lifecycle. This will ensure that we continuously improve our product base and will stay ahead of our portfolio according to market developments and customer needs.

(Slide 15) Digitalization is one of the most important themes for Knorr-Bremse. I want to dive deeper into two examples of how we are accelerating the digitalization of our business and approaching our vision.

One example I have just touched upon: Cojali is our latest acquisition from 2022. Highlights of their capabilities are smart diagnostics, big data and data analytics that will ultimately enable predictive maintenance and an aftermarket ecosystem. Cojali's solution Jaltest Diagnostics already covers more than 6000 commercial vehicle models and 200 commercial vehicle brands. Cojali's Parts solution has over 15.000 references and more than 40.000 online cross-references and their products are 100% tested. These solutions bring us much closer to our goal: to offer all market players (dealers, workshops and fleet operators) an all-in-one solution. It will generate double digit million Euros in revenues this year and it is very accretive. In rail, we have entered a strategic partnership with Nexxiot and invested in the company. Now we can offer customers access to a cloud-based ecosystem to receive data-based insights generated by specific Nexxiot-Sensors. In fact, the company has already today connected 350.000 wagons and 600.000 freight containers. Nexxiot will accelerate our digital revenues and we expect revenues of €50-70m by 2026. Both companies are good examples and they are only the beginning of the journey.

(Slide 16) Ultimately, we strive to enable the digital freight train and are thus working on digital solutions. One enabler for the digitalization of the freight train that I want to highlight today tackles the area of train preparation, which is our digital automatic coupler. The digital automatic coupler has a strong value proposition. Its electrical coupler design is well-perceived by the market, it is faster and it enhances safety by enabling safety-relevant automatization (e.g., brake test, train integrity). The market potential is high: Only in the EU the addressable market comprises 500.000 freight cars and 17.000 locomotives. As we have been working intensely on this solution, we are at the forefront of innovation and on-train tests are already ongoing.

(Slide 17) When it comes to product innovation, I would like to present our upgraded entrance systems. Through condition monitoring of our new door systems, we can significantly increase the availability, reliability, and passenger safety. As such, our door systems are in service 24/7, have the highest mean time between failure and fulfill all safety requirements. Condition monitoring gives our customers valuable data-based insights and helps them measure their KPIs. For us, this means a substantial potential: as of today, we have connected 245 trains, of which a majority was installed in London. We have already realized over €30m in contract value and have further customer orders from Germany, Denmark, Austria, Ireland and Australia – but this is only the beginning as there are many more doors yet to be connected. Failure prediction and predictive maintenance will become the next logic step to further improve availability, reliability & safety since issues can be detected and fixed prior to impacting operational performance.

(Slide 18) Finally, we as a group are fully committed to support our customers in their green transition and help them to reduce CO_2-emissions. A cornerstone of sustainability. In trucks, we can use the active caliper release as a case study. The value proposition is clear: it reduces emissions of dust and CO_2 and consumes less fuel. By the way just a few days ago our Active Caliper Release solution won the "Energy and Environment Award" by automobile association Automobilclub KS. We are very pleased to receive this award. In rail, the intelligent HVAC system speaks for itself. By automatically adjusting temperatures using most modern technologies, it can save -30% energy per year and 22% CO_2-emissions in 30 years.

Additionally, a customer is highly incentivized to transition to an intelligent HVAC system by the significant decrease in the total cost of ownership.

(Slide 19) But we cannot talk about the future, about emission reductions, our product vision and portfolio cleanup, without also giving some specific insight into our future path for non-organic growth. I understand the acquisition decisions from the past were not always the best [Hella] but be assured that I will change this. Therefore, we came up with a comprehensive framework to support positive M&A deals in the future. Let me focus here on the left side of the slide, on our strategic approach. Frank will give you later the details on our financial guardrails for larger transactions. We defined a strategic focus and are putting more emphasis on the "best ownership" principle. In essence, the target must either add to our existing capabilities in rail and truck, or it broadens the horizon of our core, when the business DNA is close to RVS and CVS. And don't worry, automotive targets are clearly not part of our search fields. In addition, clear financial guardrails for larger transactions will prevent dilution for the group's financial KPIs mid-term. Had we applied those criteria to acquisitions in the past, some investment decisions would have been different. While we cannot change the past, we can learn from it, and we will make sure that future investments are done only with proper review and the rigorous use of criteria.

(Slide20) Therefore, I am proud to say that this framework is not only theoretical but has already been put to practice. Through strategic analysis of our current target universe and with application of our financial guardrails, we have more than 10 targets on the shortlist. While margin was certainly one of the main drivers, the strategic fit is of upmost importance. For the prio A targets, I can tell you that for some, we see a clear link to either of our divisions, and a small share of the targets would be able to enlarge the scope of today. So, you could say that we will do transactions following the principle: Existing. Near. Far. And in terms of financials, the 10 potential targets would add €1.2bn in revenues in total.

(Slide 21) All this being said, let me summarize our vision: By 2026 we will have brought Knorr-Bremse to the next level and become a stronger capital goods player. This vision is built on 5 pillars supported by Operational Excellence and strong corporate culture. Our "BOOST" program will bring this vision to live.

(Slide 22) Finally, what does this mean in terms of financials? In short, our ambition is to reach 8-9bn Euro in revenues, above 14% in operating EBIT margin, and a cash conversion rate of 80-90%. Assuming that the geopolitical and macroeconomic environments remain relatively stable. As you can see, our BOOST program is strongly focused on value creation – all our initiatives are based on the ambition to increase the value of the Knorr-Bremse. I believe now it is time to hand over to Frank, who will give more details on the financials.

Frank Weber:

(Slide 24) Thanks Marc, and a big welcome from my side as well. Marc already outlined our current state of business excellence. Let me do the same in regards to our great financial profile: Knorr-Bremse has very solid financials demonstrating our high level of resilience. Knorr Bremse has a high and sustainable aftermarket revenue share, which not only generates an attractive margin, but which is also characterized by high customer loyalty. Our installed base in rail and truck continuously grows year over year and secures our future profitability. In addition, both divisions just recently posted very strong order intakes resulting in record order books. These incoming orders have already included price adjustments to compensate inflationary pressure. Our targeted cash conversion rate is 80-90%. Apart from our currently rather low cash conversion rate, which we are also not happy with, Knorr Bremse has been able to overachieve the target rate. If you just take the more or less crisis period 2020-2022 it was 88% - within the period 2019 and 2022 we achieved on average even 100%. We have a rock-solid balance sheet, which enables us to fight multiple macro-economic challenges. Our solid financing with a comfortable leverage and high equity ratio also enables us to act flexibly in operational terms. As a result of all that we enjoy outstanding ratings from Moody's and S&P.

(Slide 25) On chart 25, I outlined our financial strategy, respectively my CFO agenda, which is the Continuation of our profitable growth path._The Improvement of our EBIT margin will be generated by efficiency improvements supporting our operating leverage. Additionally, we will be optimizing our business portfolio. We want to position Knorr-Bremse clearly in line with the "best owner" principle and manage our portfolio accordingly in a value-enhancing way._Hand in hand goes the improvement of the cash conversion rate from the current level and an efficient capital allocation policy with clear priorities – internally as well as with our shareholders. This in the end will be reflected in a strong and improved Return on Capital Employed, which we will also include in our LTI incentive scheme from 2024 onwards. We want to continue a transparent and value creating M&A strategy. Our latest investments Cojali and Nexxiot are a clear proof of this._Last but not least, it is important for us to further improve our ESG values. We have a designated sustainability department since more than 15 years – which clearly shows that our approaches are intrinsically motivated.

(Slide 26) Let's get deeper into those six elements and start with organic growth perspectives of our businesses and the major drivers of those on chart 26. Overall, the underlying market demand by end customers in both rail and truck remains strong in all regions driven by the megatrends. Order backlogs are at record levels and customer demand still enjoys catch-up effects. Overall, we expect annual organic sales growth on Group level of 5-6% through 2026. For CVS, over the planning period, the truck production rate should at least slightly increase in each region. As in previous years, the biggest growth driver by far should be content per vehicle, driven by new standards, regulations and safety improvements. In addition, we expect further growth momentum from rising prices and steadily growing aftermarket revenue. In total, CVS should be able to achieve an organic revenue CAGR of 4-5% until 2026. For RVS, the expected impulses from the targeted reduction of CO_2 emissions should have a positive impact on the revenue development in all markets outside China. As you've already heard from Marc, we confirm our sales expectation for RVS in China which we provided a year ago. This market will remain important and should no longer be a burden in year-on-year comparisons. But overall, our topline will develop rather flattish there, OE reductions over time will be compensated by growing aftermarket business. In addition, revenues should benefit from increasing aftermarket sales driven by an increase of our installed base as well as price increases. In total this should lead to an organic revenue growth of 6-7% for RVS until 2026. Please keep in mind that the resulting organic revenue growth rates assume stable geopolitical and macroeconomic conditions. In addition, please take into account that divestments may happen, as previously announced by Marc, which may then influence the presented target revenues.

(Slide 27) Let's turn to the bottom-line development and what to expect in terms of profitability on chart 27. Within the BOOST program, Brownfield measures are primarily focusing on efficiency and cost improvements as well as portfolio optimization. Furthermore, it should generate the most out of the revenue potential via its operating leverage. Looking specifically at CVS: Currently we are in negotiations with our customers again during a second round of price increases. We are very confident to complete these rather soon. Our adjusted contracts and price escalation clauses will also make us more robust in the future. Nevertheless, inflation will continue to lead to cost increases. At the same time, we intend to continue investing systematically in R&D in order to secure our existing competitive advantages in the long term and generate new ones via Greenfield projects. Furthermore, the targeted portfolio optimization and efficiency improvements in particular should be reflected in rising margins. As a result, CVS should be able to achieve an operating EBIT margin of more than 13.5% in 2026.
Turning to RVS, Revenue growth should also have a positive impact on EBIT margin via operating leverage. As at CVS, the portfolio streamlining and efficiency measures should have a positive impact on margin development. Additionally, we expect the attractive aftermarket business to grow stronger than the OE business as a result of a further normalization of ridership in trains. On the other hand, clear headwinds should impact profitability. They are: 1) A change in product mix, because the revenue share of our non-brakes business should increase stronger than the brakes business. 2) The regional mix should also change towards more business from non-China countries as China should develop flattish. And last but not least, increasing investments and R&D. As a result: In 2026 we expect that RVS should be able to achieve an operating EBIT margin of more than 16.5% and the group should do more than 14%.

(Slide 28) Let's dig deeper on what to expect from our cashflow development. No doubt about that: Last year our cash Conversion rate was low. Higher interest rates led to a change in payment behavior among our customers. In India, there was a discussion with one customer about technical solutions that resulted in higher overdues. This issue is in a settlement phase and the customer has made a part of the outstanding payments in the meantime. Chinese customers have stretched their payment terms. This is not a new situation and probably also continues to harbor a certain degree of uncertainty. To be quite clear here: we are not recording any payment defaults. Our inventory still remains elevated for supply chain reasons. Overall, we see that our working capital has increased stronger than our revenue line and yearly average scope of days have increased to roughly 70 days last year. Therefore, it is our clear goal to reduce this increased level in the coming years. Delivery capability and delivery reliability have become more important, but I expect a value of around 55 days to be achievable, which should then also support Free Cash Flow by around €300 million. The two major measures to increase our cash conversion rate again are: First of all: the improvement of working capital for all the business regions. With clear targets for the scope of days for raw materials, semi-finished and finished goods. On the accounts receivables side, we will also improve our claim management process to the best we can. That is why we have defined and implemented our "Collect" program. It is made up of cross-divisional teams and will establish clear measures for all key working capital ingredients such as from direct/indirect purchasing, logistics, supply chain as well as sales and aftersales. Secondly Capital Expenditures, which is important to set the base of our businesses, but with a clear prioritization and optimization of all investment projects. Overall, please keep in mind that Free Cashflow is an important part of our company-wide short-term bonus system. Our clear goal is to achieve a cash conversion rate of 80 to 90% sustainably going forward – we have proven to deliver that and we will do so again in the future!

(Slide 29) Moving on to chart 29. Capital allocation is a very important topic for us. In general, our capital allocation has remained unchanged in recent years and follows a clear list of priorities. Within the group we allocate cash for investment projects according to the net present value of future cash flows, it's payback time and the return on the invested capital. Our first priority is the organic growth of our business and dividends to our shareholders. Mid and long-term growth drivers for both divisions are in full swing. Therefore, we want to drive innovation and technology leadership of Knorr-Bremse to support that organic growth best way with an R&D ratio of 6-7% and Capital Expenditures of 5 to 6%. In addition, our payout ratio for dividends is 40-50%. Our second priority level is M&A. Inorganic growth via M&A follows similar criteria as internal investments, with focus on net present value, ROCE as well as EBIT margin and the respective Free Cashflow potential. In case we do not have value-creating projects for organic or non-organic growth, we would consider share buybacks, but that's our third priority.

(Slide 30) Marc already highlighted the strategic focus areas regarding M&A. I will now talk on chart 30 basically about our defined financial guardrails for such larger transactions, which we clearly tightened. Let me specifically highlight the following topics: Potential targets have to achieve an EBIT Margin of at least 14% midterm to support our profitable growth. So, we will not accept dilutive businesses vs. our group targets anymore midterm. Knorr-Bremse should achieve a return on capital employed of at least 20% stand alone. It is therefore also logical that targets have to achieve at least this value in the medium term. In all future transactions, in both known and new business areas, Knorr-Bremse must be the best owner. What do we mean by this: the business models of new companies should overlap to a high degree with those of RVS and CVS, e.g., "customer conviction through innovation/quality", "asset light", "decentralization" and "clear USPs and high margins", as well as "high AM revenue share". Needless to say: all transactions have to be value accretive at first which we will measure by NPV discounted by our risk-adjusted weighted average cost of capital.

(Slide 31) Let me reiterate on Sustainability and in more general ESG as fundamental and integrated layers of our business strategy (Slide 31). <u>First of all</u>, we have significantly expanded our ESG-Target catalogue that guides our activities and even increased already existing target levels. Let's take climate change: We have increased our Scope 1+2 target to reductions of 75% by 2030. Besides numerous fuel switch projects substituting fossil fuels, we are continuously increasing our own generation of renewable power. We have defined in addition an ambitious Scope 3 target and we just this month delivered on our commitment to obtain target validation through the Science Based Targets initiative (SBTi). This was a major step forward and shows our strong commitment. Secondly, these targets and respective KPIs are now being more and more integrated into our decision-making processes, be it for example via the introduction of an internal CO2 price or by reflection of ESG in purchasing and investment decisions. ESG is also a major part of our Short-Term Incentive Scheme and is to be integrated in the LTI as well! Thirdly: we are progressing with our milestones. We have significantly increased Scope 3 data integrity and obtained limited assurance from our auditors respectively. Last but not least, we integrated ESG consistently in our three most recent financing activities. As you can see, ESG is an integral part of our daily activities and we walk the talk - our ratings proof that as well!

(Slide 32) Coming to the potentially most important slide for you: Our overall targets for 2026 and the margin bridge, summarizing how we want to improve (Slide 32). Let me be clear: we are not at all satisfied with the operating EBIT margin as of today. Certainly, it has been burdened by macroeconomic pressures such as the war in Ukraine or a lower market in China, together over 200 basis points, or even the high inflation. The main drivers for our EBIT margin improvements until 2026 are: Roughly 2% points by Operating leverage and operational excellence, which by and large confirms the organic growth and the resulting economies of scale that we gave at the last CMD. Roughly 2% points by portfolio optimization of either selling or fixing businesses: we have analysed which components and technologies don't suit us. The divestment process has already started and we will implement it consistently. A burden of roughly 1% point from investments and R&D in Greenfield activities: as Marc said, we will provide more details on these future growth fields with the presentation of full-year figures 2023. Overall, we expect to achieve revenues of € 8-9 billion in 2026, an operating EBIT margin of more than 14%, which should then lead to a cash conversion rate of 80-90%. Please note that we have assumed stable geopolitical and macroeconomic conditions for these targets. Thanks a lot for your attention and with that, back to you Marc.

Marc Llistosella:
(Slide 33) Thank you, Frank. So, as you all can see, we have done more than define a clear vision of our strengths and potentials. And we updated our mid-term targets. Margin improvement is our key priority. Our long-term above market growth is fueled by mega trends. And we have implemented a good & disciplined value-oriented M&A strategy. This is how Knorr-Bremse will act in the future, and this is how we sum up our "BOOST 2026"-program. With a shared target vision and strictly defined measures, I am convinced that our company with its resilient businesses, the growth potential in the aftermarket and its rock-solid financial basis will soon be back on track. With that, I believe we have given you a clear overview of our future roadmap. As of today, my main message to my colleagues at Knorr-Bremse is this: Let´s get the job done! And it´s all about: Execution, execution, execution! Thank you very much. Thank you for your attention.

Andreas Spitzauer:
Thank you, Mr. Llistosella. Now there will be a short break between the presentations and the Q&A session. Thereafter and during the Q&A, the webcast will continue without the video. Please dial in via telephone and mute the webcast. If you want to ask a question, it would be very kind of you to limit yourself to two questions during your slot.

Q&A Session Strategy Update 2023

Operator:

Ladies and gentlemen, we will now start the Q&A session. If you would like to ask a question, please press nine and star on your telephone keypad. To withdraw a question, press nine and star a second time. And the first question comes from Sven Weier, UBS, please go ahead with your question.

Sven Weier:

Yeah, good afternoon, and thanks for doing the call and taking my question. Two questions please. First one is on the chart number 26, where you outlined the organic assumptions. Is it right that for the CVS business, you assume up to 500 million disposals until 2026 and rail up to 300, if I made the right calculations?

Frank Weber: Sven, you wanted to raise two questions. I assume.

Sven Weier: Yeah, I can go with the next one.

Frank Weber:

No, no, let me take the one first. First of all, with the organic growth figures, we wanted to give you a clear hint what this business is capable of, how do we perform in regards to the respective market developments. And that you can also see as a proof point that we will be also in future outperforming the respective markets on the truck side, basically driven by content per vehicle and on the rail side by similar, but we don't call it content per vehicle, but similar approaches of course, of bringing their values into the respective trains over time. So that organic revenue growth is therefore for your guidance in order to see the performance of the business, the eight to nine billion we came up with, of course certain elements in regards to the portfolio adjustments that we have already considered in this range of eight to nine billion. Because we have to as well also give you a certain indication where our profitability would stand by the end of 2026. And that's why it's baked in a certain amount of portfolio adjustments. I can't confirm those numbers because it's not exactly those numbers, but it's a certain amount baked in on those components of our businesses where we have already a certain thought agreement.

Sven Weier:

Okay. Understood. And the second question was actually on, when we think about the phasing of the margin target, do you see that rather as a backend loaded one or should we already see, for example, a more tangible improvement in 2025? Because I do recollect that next year you have basically the Legacy Rail contracts rolling out. And then I was just wondering on the M&A... Sorry, on the disposal side, whether those disposals you have in mind, do you rather look for a fast execution so that those companies should have left Knorr during the course of next year already?

Frank Weber:

Sven, yeah, I would definitely say it's not backend loaded. What we see in terms of improvement towards '26, you rightfully pointed out the RVS situation of the long-term contracts that we have there with a high chunk or big chunk of revenues in this year that do burden our margin within the year 2023. And this to a great extent will go away turning into '24. So you should already see moving into the next year a certain profitability improvement. So it's a clear answer and simple answer, it's not backend loaded. It's a rather continuous development. And also let me reiterate on that, even though you don't have the question raised yet. You shouldn't expect [48:00] each and every portfolio adjustments to take potentially that long like Kiepe divestment does because it's a fundamentally different business what we have with Kiepe or it will not take us three years to execute on some of those portfolio adjustments.

Sven Weier: Understood. Thank you, Frank.

Frank Weber: You're welcome, Sven.

Operator:

And the next question comes from Akash Gupta of JP Morgan, please go ahead with your question.

Akash Gupta:

Yes, hi. Good afternoon everybody, and thanks for your time. My first question is on your new ROCE target, and now you target more than 20%, and previously it was more than 30%. And maybe if we can talk about whether this includes some dilution that may come from some of the M&A deals that you plan to do. And my second question is this 1.4 billion of revenues that you want to turn around, **[49:00]** is there an indication in terms of how much cash costs you might require in terms of restructuring or maybe if you have to sell some of the loss-making businesses, probably you may need to pay somebody money to sell it. So, an indication on cash cost for fixing that 1.4 billion revenues to lift margins by 200 business points. Thank you.

Frank Weber:

Akash, thank you very much for your question. In regards to ROCE, formal 30%, so to say, have multiple reasons why this number is going forward, the 20-plus number. There are major reasons like inflation hit us, of course in the working capital, the reduced profitability that we have been seeing over the time. We talked about the drivers of this quite intensely. You see also from M&A activities of the past always, usually you have a certain amount of goodwill that additionally sits **[50:00]** on top to the just operational working capital then in your books and all these ingredients, so to say, together led to this development. In regards to the cash needed for the M&A activities, clearly we do in regards to our internal plannings always assume a certain amount of cash flow needs, which is definitely by definition not included in the free cash flow. It's an investing cash flow. But we do properly assume a certain amount of course cash needs for those investments that we would be having over time. I don't disclose on those in order not to give an indication what exactly we are planning to do there. But it's definitely included in the planning and in regards to potential one-offs, if you might have thought about that as well. We don't see a bigger cash needs for **[51:00]** the portfolio optimizations going into the future.

Akash Gupta: Thank you.

Operator:

And the next question comes from Yasmin Steilen, Berenberg, please go ahead with your question.

Yasmin Steilen:

Yeah, thanks for taking my question. I have two on the digital strategy. So, so far Knorr comes across as a product company, yet you have very ambitious targets also for your software products. Given your 6 to 7% R&D guidance, which proportion is earmarked for the software development going forward? And could you also please elaborate on your strategies to monetize the software offering going forward? Thanks to you.

Marc Llistosella:

Yeah, I will take that. Thanks for the question. In terms of the software separation with hardware, as we're, especially in rail, we are doing solutions. So, we are not doing separation of hardware and software, so that means we are way of providing a solution, **[52:00]** which is then including hardware and software. So that means we have not separated what the software return on investment, what's the hardware's return on investment. What I can say is that in a purely software-driven system like Cojali, the margins which we aspire are on a completely different form. Software in this regard is not related so much on the aftermarket service. So hardware is more and more dependent from the aftermarket. So we cannot say at the point of transition, what is the profitability, because then we have to say it for 10, 15, 20 years. In terms of software, this is coming much, much faster. So, it's less the amount itself, which is very different. It's more the systematic of it. And here we have margins in mind, which are by far above 25 to 30%. And we have also the tied duration of return. We have no longer, the 10, 15, 20 years in mind. We are here **[53:00]** calculating with things, which is in the duration of one to five years. So, this is in regard of the software, to your first question. Your second question, please help me. Your second question was in regards... Can you...

Yasmin Steilen: Yeah, basically elaboration on your strategies, how to monetize in the software offering.

Marc Llistosella:

How to monetarize it is to make it a service of an added value to the customer. So, software by itself is nice to have, but it has to be monetizable with the customer. So that means it's very fast, customer focused. And as I try to explain, when it brings added value to the customer, for example, predictive maintenance, then you have an increase of the upper side, and then that means for the customer pure income increase. And that is what is monetizable. Everything else is a nice to have. So, it's very clear, software must have an added value **[54:00]** and an immediate impact on the customer's economics. Otherwise, we will be very hesitant to go into.

Yasmin Steilen: Okay, thank you.

Operator:

The next question comes from Gael de-Bray, Deutsche Bank. Please go ahead with your question. Your line is...

Gael de-Bray:

Oh, good afternoon. Thanks for taking my questions. So I have two to start with. Can you hear me now? Okay. Sorry about this. I think there's a bit of a timeline, so I apologize for this. Anyway, my two questions are the following. Firstly, you've mentioned you had too many legal entities branding too much complexity. **[55:00]** So as you reduce complexity what sort of SGNA cost optimization do you intend to achieve? Do you have any specific SGNA to sales ratio target in mind, for example? So that would be question number one. And question number two regarding the 200 bips margin improvement that is expected to come from portfolio actions. So I guess it would still be helpful if you could provide a bit more granularity on how exactly you intend to fix the businesses that will not be divested and discuss maybe what are going to be the key action points there. And maybe in relation to this, based on the 200 bips margin improvements you expect to achieve is it fair to say that the 1.4 billion of revenue generate an average margin of about 4%? **[56:00]** And I guess I'd be interested if you could maybe separate the 1.4 billion euros of revenue between the pockets that are truly loss making and the pockets that are not generating margins of let's say, mid-teens... Not mid-teens, sorry, but low single-digit and maybe mid-single digits. I know it...

Frank Weber:

So, I take the first, Marc takes the second, and we help each other out in case. So, in regards to the legal entities, we've had been having two years ago, some 145 legal entities, 146 legal entities. We've been reducing those already down to a level of roughly 126 at this point in time. And we continue to do more. We have a clear plan what we want to do in the respective region. And it's not **[57:00]** because of the sake of reducing some 100,000-ish levels for annual auditing cost or tax declarations or stuff like that, because we believe that the complex of the system is the more so to say sneaked in cost you have in the overall system that is defocusing you from the real business. We will not at all change our general philosophy of having a decentralized entrepreneurially thinking P&L responsible way of setting our business and our governance structure up in the company. This is not at all the case, but we think there is so much baked in within a kind of overwhelming complexity. And we do think that we have not reached yet in each and every region or each and every country with our current footprint, the optimal setup with the whole **[58:00]** amount of synergies that could be achieved. And that is the reason why we're doing it. And of course, we are baking those numbers that we internally have as a target in into then the respective SGNA targets of the businesses, the COCs, the BUs, and the divisions respectively. So that is the way we are thinking on this.

Marc Llistosella:

Good. On the second question, in regard to the 200 basic points in margin improvement, you had a lot of questions within this question, so I have to be clear, I cannot tell you exactly step by step how we'll improve the margin, but I can tell you it goes faster. It'll not take us three years, especially when it comes to sell it. What we can see is we made a very, very harsh judgement on the companies and the units in at least five **[59:00]** years period. So we are not doing a fast rush but we are also not being very forgiving, then you cannot achieve a minimum margin within five years, number one. Number two, the question is, do you have crossover character with your position, with your product in this respective units? If this is the case, we have to be very, very decent when it comes to customers because clients and customers would be eventually irritated if you just step out. So it has to be very clearly communicated. It has to be made clear that there's no disadvantage for any client and any customer when we are changing our ownership principle. Number three, the ownership principle, it could be also, there is always the extreme. We... also have a partner who is doing eventually in temporary **[01:00:00]** majority. That would be also an approach. But one thing for sure, we cannot allow that the very, very, very, very healthy core business of Knorr-Bremse is dragged down by this, what we call dilutive business. And here it's a very, very clear message. This business has to improve significantly. This business has to prove also their strategic relevance for the company or this business, and I come back to the best ownership, is not in the best hands. It could be a very, very good business, but eventually not in our hands are the best hands. So that means the 200 basic points, by the way, are the minimum, what we have settled, it's very conservative calculated. And you can be sure we will not wait now, the next three years to make that happen. We want to see the results much, much quicker. And we want to give also very clear signal also to the, let me say fixable units. **[01:01:00]** There is a way and the way can be with our company or the way it can be without our company. So, in order also not to dilute this kind of assets, we are very clear, most of these companies have a substance, nearly all, but it seems to be that it is not really fitting to our current business understanding. So that means we really discuss the ownership model, which kind of ownership will it be? And to say it in short words, the 1.4 are relatively balanced between fix it and sell it. And you will see, and you will hear eventually already in the next six months, some of the major steps to clean this up.

Operator:

Okay, the next question comes from Alexander Virgo, Bank of America. Please go ahead with your question.

Alexander Virgo:

Oh yeah, thanks very much. **[01:02:00]** Good afternoon gentlemen. I appreciate you taking the time to chat. I wonder if you could just talk a little bit about what you believe have been the reasons why you've seen a deterioration in the fundamentals and why you need to have this sort of review of (01:02:21). I guess if I look at the 13 and a half and the 16 and a half, '26 margin targets versus your history on slide

27, you're taking truck back to roughly where it has been in the past peak, I guess on rail notwithstanding China trying to go back to peak. What do you think has actually come unstuck, if you like? What is it that has deteriorated, has driven that deterioration notwithstanding the sort of the macro side of things? I'm just trying to get a feel for what you think internally. You've identified that can be **[01:03:00]** reversed or addressed or fixed. I'm just trying to understand the thinking there. Thank you.

Marc Llistosella:

So, Alexander, if you allow, I would like to try to answer you the question because I fully agree what you say. The impact of China, rent of the party has an impact on RVS of roughly 300 basic points. The impact on truck was by far smaller. It was really by far smaller. And the impact of Russia is also completely different in terms of the amount of margin. We can make it very, very crisp and very brutal. If you and your rights, RVS, we were used to have RVS in the range of 18 to 19% margin, right? That was it. That was promising and that was very good. From this margin, we have **[01:04:00]** honestly, 100 basic points are gone. They're lost, they're gone. This is Russia. These 100 basic points we have to compensate. So, one, let's take the 18, diminish it by 100 you have 17. And then we had a China partner, which was exceptionally, it was an anomaly. It was not the normal, but it was taken as a new normal, even, it lasted only for five years. Because when you see in the past and also with our competitors, the margins here are getting normalized. So this impact is very, very much on RVS. And if you take the 200 from the 17, then you are ending up with something, a normalized China, normalized business is RVS roughly at a 15. You can say, yeah, take it little more, 16 and a half, 15 and a half. In trucks, we didn't have that. In trucks, we had of course also an anomaly because the market in China was 1.6 million trucks in 2021. **[01:05:00]** But the impact, the profit impact was not comparable to RVS. So that means by having the two not coming back, in trucks we're aiming very, very challenging 13.5 and above. Yes, you're right, this is challenging. In rail we are adjusting this kind of anomaly of 200 plus 100 basic points deducted from the 18 or sometimes from the 19. And you come up with something which is reign of 15 to 16. Now you can say, so 15 to 16 or 16 and a half, this is the new normal. And we say it could be more, but we would like to see the adjustments, which we do in the next six months. And then we know better whether we can compensate the Russian business in the future and whether we can live with the new normal in China. So this is the main reason why we have given us a very officially demanding target for CVS and a more modest target **[01:06:00]** for rail, because here we would like to consolidate and then we will come back in February next year, whether this consolidation is rightly understood, and whether we can go beyond or not. Hopefully this answers your question.

Alexander Virgo:

Okay. No, that's very helpful. Thank you very much. I wondered, Frank, I'm going to push you a little bit on cost because there must be a cost to achieve this. Is it fair to assume or a fair assumption to assume a one-off cost equivalent to the basis points expansion? Or is that too harsh?

Frank Weber:

Too much. That's too much. I would say non-cash relevant OTEs could come with a three-digit number. But the lower is possible.

Alexander Virgo: Okay. That's certainly helpful. Thank you very much.

Operator:

The next question **[01:07:00]** comes from Lucas Ferhani, Jefferies. Please go ahead with your question.

Lucas Ferhani:

Thank you. The first question is just on the revenues on the review. So is there today a share of those kind of 1.4 billion of revenues that you are already convinced it needs to be sold and could you say roughly how much or is there a scenario where you are able to fix all those issues and you end up keeping the entire portfolio? I'll just put the first question now and have the second one...

Frank Weber:

As I said before, when it's been asked the question in regards to the eight to nine billion compared to the CAGR, the organic growth CAGR, we have of course made up our mind on certain exits already in the board. And those we have best possible included in our financial plan going forward. I would **[01:08:00]** say it's fair to assume that this is not in the range of the 700 yet out of which Marc spoke also in the previous quarter or 700 plus 700 you remember. And so, I would say it's from 300 to 500 around that is what's currently baked in as an assumption.

Lucas Ferhani:

Okay. Perfect. Thank you. And the second question is related to that, have you already kind of launched sale process? Obviously, these are kind of underperforming businesses to an extent. So how confident are you you'll be able to sell those and not only sell them, but that attractive kind of prices on your side?

Frank Weber:

On one plus, I would say one and a half of those businesses, we have already started the **[01:09:00]** process preparations. One is basically officially started and the other we are in the preparation phase so to say, I think that's important to understand. Then the others would then come sequentially right after. And maybe also just as you ask this question, maybe one addition to the answer I gave before and to the colleague who asked about the one timer, a potential one timer, this would be of course in the worst case. So, it's a calculated figure in case we wouldn't get the penny so to say for those assets. So, it could also be lower, just that you get these hundreds potentially in the right dimension.

Lucas Ferhani: Perfect. Thank you.

Frank Weber: You're welcome.

Operator: The next question comes from Calvin Chen, Credit Suisse. Please go ahead with your question.

Calvin Chen:

Hi, thank you very much **[01:10:00]** for taking my questions. I've got two questions. The first one is on the detail execution of your disposal programme of around 700 million sales. So as far as I understand, you run the entire business based on a kind of five times three business matrix being five major business lines times three key regions, and then for times two of the two divisions. So, in terms of how you want to do your disposal, can I just check whether it will be done at a more divisional level, i.e. maybe majority of say three to four out of your 30 business divisions will be sold, or is it covering some part of your different divisions? And further to that, if it's latter, how do you see such disposal will change the current dynamics and synergies between the different business lines? And the second **[01:11:00]** question really is whether you've got a regional focus of the disposal or it's more widespread across different regions. Thank you very much.

Marc Llistosella:

So, what is the regional disposal or regional allocation of... You call it disposal, I would call it new solution for the assets. There's no focus, but I can tell you only that the Asian part is so far underrepresented, number one. Number two, is there any loss of synergies because of the change of ownership? So far, not foreseeable, we don't see any risk or any adverse development, which would make us think that there's a lack of synergies. Number three, when it comes to the form of new ownership for the respective asset, we can only say that number one in this, 3.1 in your question, the companies **[01:12:00]** which we looked at are worth to fight for. Number one, none of the companies we looked at are worthless or have no substance. This makes them traceable and tradeable. That means also that the ownership question, which I try to underline, is of absolutely utmost importance for us. It could be that these companies were in a situation because of our management, very clearly. And there's something currently ongoing where I have a strong opinion about it. You know all what kind of assets we are currently in the process of selling. And I can tell you from also my track record, this company has potential, but it seems to be that the Knorr-Bremse has abandoned this company for four years and eventually also based on the Corona, but **[01:13:00]** the company has a value. It's not like we have some crap here. These are companies which are good companies, but it looks like that in our business logic, these companies are not really fitting in. And I think this is very important because we want not to dilute this companies like, oh, they're bad. No, no, no, no, no. That's not the point. The point is, if we continue to manage these companies in this way, it means no added value to us, plus not to them. It could be very, very possible that one of the assets or the other asset, which will be then out of our reach, will absolutely succeed in the market. So hopefully this makes it very clear, we are not having here a box of stashes where we don't have no idea what to do with it. It's just that it is not accretive to our margin. It is not additional to our cross-selling. So there is no impact. And only when this is agreed, and when this is, **[01:14:00]** I would say judged by the ones which were in the companies, then we are making the call to go for another ownership. And I really call it an ownership disposals. I know it sounds a little bit disrespective, I would call it really for no ownership because it is very often also on our side that we failed, period. We failed, not only these assets. And I think this must be a very strong message because if we always claim that we are the best owners, that we are the top managers, then sometimes it goes in the completely different direction. And that has to be also very clear. And this is very important for the future. Very, very important. And you all know, especially in this call, that the ownership of the assets sometimes is more important than the asset itself. Who owns it and what are you doing with it? This sometimes is more decisive than what are you buying? **[01:15:00]**

Calvin Chen:

Got it. Thank you very much for all the details, but just one quick follow up. In terms of companies that you mentioned, are you referring to say a product business line in a certain region? For example, say it's air tank business, air tank company in North America, for example. I'm just making up products, but is it like each product line as a company or something else?

Marc Llistosella:

In terms of greenfields, I think you want to know exactly where we enlarged in our scope. Nothing is excluded so far. It has to be only the guardrails, what we gave in terms of strategic guardrails in financial guards, have to be absolutely aligned and have to be taken care of. Everything, what is, you know. In the past there was here I think two years ago, there was a lot of turmoil when we spoke about **[01:16:00]** an automotive supplier out of the blue, first. And that I can give you very clear. Out of the blue will not come anything. You will see immediately the logic. And if the logic is not seeable, then we will explain it to you and then you can say, "Okay, based on which criteria do you have evaluated the asset?" And these criteria are upfront, not after, because after, you can bend everything what you want. So we will be very clear and very, very word by word what is making sense, what is not making sense. So when you say, "Can you define or can you give an indication on the greenfield?" I would say this would be a slightly too early, but in six months we know exactly where we go. And of course you know it, I know it, we know it. We can't be too precise, otherwise the assets which we are aiming are exploding in terms of value, right? Which would be not in the interest **[01:17:00]** of any shareholder of Knorr-Bremse.

Calvin Chen:

Yeah. Thank you very much, Marc, on the... Actually info on greenfield, but really I was really referring to brownfield. When you talk about company not in the who have an ownership in someone else's hand in terms of that company, what exactly it is? Is it a product line?

Marc Llistosella:

So to be very honest, I will not give you any name. But what I can tell you in terms of brownfields is very clear. A brownfield M&A activity will be accretive or it will be accretive in short terms, because otherwise it makes no sense. If we think we can buy something in and then be the masters of a disaster, no, that's not how we work. We will only take something into acquisition, which makes sense in terms of financials, especially in brownfields. And this is **[01:18:00]** the reason why we differentiate between brownfield in terms of cash generating targets and assets and let me say startups. And that is also, so in startups it's a different name of the game. Here we can say this is very intelligent and very, very, very interesting technology, which we do not have in our hands. So, we could go away, which is also leading to five years of not diluting, but not accretive. In terms of brownfield, this will be very, very difficult. I would say it is nearly impossible under other terms. So, everything, what already generates cash has to generate margin, otherwise it'll be very, very difficult, not to say impossible, to acquire.

Calvin Chen: Got it. Thank you very much, Marc.

Operator: The next question comes from Marc Zeck, Stifel. Please go ahead with your question.

Marc Zeck:

[01:19:00] Good afternoon and thank you for your time. Two questions from my side. We'll take them one by one. First question, just clarification on let's say Kiepe and the Sheppard front. Are these disposals already factored in, into your guidance or they may come on top?

Frank Weber:

So, definitely Marc, as you rightfully said Kiepe is baked in. We have been very transparent with you in regards to Kiepe. A different animal when it comes to the business model compared to our remaining Knorr-Bremse business. Therefore, it's also a bit complicated that sales process, but this is definitely baked in. What's not baked in this, any kind of other name out there. Also to say that I could put in my mouth currently. So as Marc said, let us sort ourselves **[01:20:00]** out and try to get the best value out of those deals. But not to mention the names beforehand, if you are okay with that, Marc. This Marc. Oh, this Marc Zeck. Not...

Marc Zeck:

Yeah. S,o the second question is a bit on the same topic. So, I tried to look at the annual report (01:20:29) and the affiliated companies and their net income and their equity to figure out which companies or which let's say subsidiaries might be thrown for restructuring or divestment based on ROE also and I'd say Cojali and (01:20:47) doesn't really strike me as let's say attractive from a profit perspective right now. And you mentioned those in the first page today, are these companies then **[01:21:00]** part of the major restructuring or do I miss something if I look just at the notes to the annual statement that you had.

Andreas Spitzauer:

Marc, if I understood correctly, you asked about the annual report in the backup where we have kind of listed the legal entities, the single ones, and the profitability. And let's say if there are some maybe potentially could be divested say by and large.

Frank Weber: What's Cojali is all like?

Andreas Spitzauer: Yeah. But also called Cojali in terms of...

Marc Llistosell: If Cojali is highly profitable, why should we divest?

Marc Zeck:

Yeah, if I just look into the statement I see Cojali's ROE on 2%, just using numbers in there. But you say it's... Probably it says some let's say lost in between EBIT **[01:22:00]** and net income, or is it just that using those numbers that are in the notes of the statement don't give me a clear picture on the probability or on the ROE of those subsidiaries?

Frank Weber:

Yeah, maybe approach your question potentially that way around. First of all, given the way how we measure the Cojali business in our system of Knorr-Bremse is extremely accretive. And I think we have implicitly outlined those already in the quarter one, and we will do so again in quarter two, where you can see that the EBIT margin of Cojali is above 30%. So to make that pretty clear, if you look at the annual reports, you usually basically only have standalone **[01:23:00]** kind of legal entity point of use. But this is not the way we usually look at the businesses because you have to look into all the collaterals and in positive terms, all the synergies that are created with a certain business. So we basically look at the start of all things towards a centre of competence perspective or business unit perspective, which goes far beyond the just legal entity scope of any business. And to a large extent, also, legal entity scopes are driven by transfer pricing within the group. So you have to also consider what is kind of tax-wise just purely given whire certain regulations. That's another thing, and of course a third element, and hopefully not too confused with too many exceptions that you have to take when **[01:24:00]** just looking at the annual report. But the third thing is also PPAs, that you have to look at where you do depreciation on a certain goodwill, as you know. And that might also play into those kind of figures, but that's not the way we purely look at it.

Marc Llistosella:

Only to emphasize, Marc, to emphasize Cojali very clear, operational Cojali is a treasure, it's a diamond. I'm reminded Yasmine Steilen, she asked, what is the difference between software and hardware? Which kind of margins do you expect from the different areas? Cojali is a perfect combination of both, plus a high concentration of the aftermarket. So you can imagine that for us, this is super interesting and it's extremely good because the owner is still on board. And by the way, this is a very intelligent way of getting something consolidated. **[01:25:00]** We have not bought out so far, and we have no plans, the owner of this business. So we have here 51% ownership...

Frank Weber: 55.

Marc Llistosella:

55, and we still have the owner and founder on board. So that means there is a very intrinsic interest on both parties that this business is flourishing. So this is also an intelligent approach of right ownership. We could have said, "We just buy you out." And that's exactly this zero or one approach, which we want to change in the future. There is a reason to have different forms of ownerships. There's different reasons to have a different form of centralization, standardization, but it has to be seeable at the end of the day, and it has to be seeable in the operating business. The operational business of Cojali are highly profitable, highly accretive, and by the way, also very, very much in terms of crossover selling for our own products. So in terms of strategic **[01:26:00]** fit, a clear yes, in terms of margin, a clear yes, in terms of accretive business for the future, clear yes. And in terms of aftermarket, yes, high share of aftermarket, also a clear yes, this is how we would evaluate this kind of asset.

Marc Zeck: Thank you very much…

Operator:

And the next question comes from Delphine Brault, ODDO BHF. Please go ahead with your question.

Delphine Brault:

Yes, good afternoon. Thanks for taking my questions. First, can you comment on your pricing policy and what pricing assumption you have taken in your EBIT bridge? And the second one is, can you detail a little bit the cultural change you have started to implement? What did you put in place concretely to change the culture in the company?

Frank Weber:

[01:27:00] Delphine, good to hear you. Of course we have for the years, let's say in the bridge for the years '23, '24 quite concrete assumption for the prices baked in, those are the ones that are currently on the table with our customers in both rail and truck. The difficulty is more on the project business side than on the truck side in order to pass through the respective prices. So that's our best guess in regards to pricing. But for '25, especially then, and for the year '26, it's just a very rough assumption, basis is that the inflation assumptions that we also have for those years which we assume to get lower a bit over time, beyond '24, but only a little bit. So if you take the revenue growth out of **[01:28:00]** these years, '22, towards '26, we have basically less, significantly less than a third of these revenue improvements coming from price assumptions. Delphine, can you hear us?

Delphine Brault: Yes, thank you. Yeah.

Frank Weber:

(01:28:35). If you allow me to ask, Delphine, the second question that you had, could you rephrase that please?

Delphine Brault:

Yes. Sure, yeah. I was referring to your first... On the BOOST program, the first point was culture development, and you say culture development is a must for the success. **[01:29:00]** And you explain that you want to change the culture into the company. And I'm wondering, what did you put in place concretely already in the company?

Frank Weber: Thank you. We understood that.

Marc Llistosella:

Yeah. So on the culture, we do it relatively easy. First, you live what you talk. So that means the leadership team is very clearly confronted with the new demands. And secondly, we ask the leadership team, what kind of leadership principles should the company have? The leadership principles which we had was now here for I think 11 or 12 years. And we asked the leadership team by themselves, "Do you agree to that? Is it still valid?" And they disagreed and said, "No, we have to adapt these leadership principles because it's not any longer valid in this form." So what we do is we are very... **[01:30:00]** Part of that is top down, but most of that has to come from the leadership itself. So we include the summary of what we got from the last time when we asked our employees that was coming from October. So we asked, "What kind of problem areas do you identify?" And one of the areas was the messenger is killed in this company. So, we addressed this very clear to the top team. We said, "So this is how it is perceived, how do you deal with that?" And secondly, we had also other adjustments to be taken on, which are having an impact on how you deal with each other. So, the thing is, Knorr-Bremse in fact, it's not a European, it's a global company. So, we have completely different cultural understandings when it comes to societies. We have more than 4,000 employees, which are in China. **[01:31:00]** We have more than 4,000 from India, we have more than five and half thousand from U.S., and so on. So that means we have to come to common trades. And this common trades have to be... It has to be understood by all. So that means we have started multiple programmes of exchanging opinions. We have this kind of... How you say (01:31:21) discussions with the top managers. We have fireplace discussions, I think it's called in English. We have an exchange, which is also then appreciating any form of adjustment in the company in terms of process. So the whole cultural programme is a full-fledged programme, which goes now and started in March, by the way. And it is now ongoing for the next two, three years. It's an ongoing thing. Of course, you cannot top down it. You have to have it really associated with everyone, especially with the leadership team. And now also to the bad side, or let me say the dark side of this program. **[01:32:00]** For the last six months, I offered everybody to follow and to be part of this story. And now people know where it's going. And now people can decide for themselves, especially leaders, whether this is a programme, this is a way, this is a journey to take. But from now on, I would say the planning is now a little bit over, discussion is getting more intense, and now everybody has to decide whether he's on or he is not on, or she. And I think that is also a cultural new thing. We are not hiding information. We are not hiding as also in the talks with you, we are not trying to get away from a clear question. We are trying to get it on the point, on the spot, and we're trying to make it very, very haptic. And that means also that the feedback of the leaders will be more and more a 360 degree, **[01:33:00]** where we see the leader not only from top down, but also from up and down and also from different perspectives. So it's a full-fledged leadership programme, which has all the ingredients, which I tried to describe. Hopefully this gives you a form of understanding how this whole thing is started.

Delphine Brault: Yes, thanks a lot, very informativ.

Operator:

And the next question comes from William Mackie, Kepler Cheuvreux. Please go ahead with your question.

William Mackie:

Hi, good afternoon, Marc, Frank. Couple of questions. On your slide 21, the M&A targets, can you just give a bit more flavour of where you are, from lifting or identifying the targets on paper to actually engaging with the people and the owners and starting a constructive discussion about **[01:34:00]** the potential benefits of working more closely in partnership or through ownership with Knorr-Bremse. So how far down the track are you with these targets that you've identified? And when is it realistic to start imagining that you're going to convert into some form of capital transaction? And the second question is more detailed actually, in your bridge chart on page 32, you highlight that there's a 100 basis point drag from a step up in R&D, but your current R&D is already close to 7% of sales last year. So it seems that you are actually going to push your R&D levels above your current R&D ratio by potentially 100 basis points. So can you perhaps provide a bit more of an indication of where **[01:35:00]** that incremental spend is planned? Thanks.

Marc Llistosella:

Thank you for the question. We will split the question. So how far are we on our targeted assets? This differs. Some of them are very close. We are already in discussion where none of them can be disposed. None of them can be published because that would be suicidal. And some of them are just where we are in non-exclusive discussion. So that's the point. That is where we are. Now, your question was implying when do we can expect some significant news on it? You can expect it already the next six months, but you can expect some of them, because we said more than ten Prio A targets eventually come through in the next 18 months. So you have spectrum, and as it is deal related, we have to be careful in the interest of our investors and shareholders. **[01:36:00]** To the second question, in terms of the R&D, the downside, I think Frank is very now eager to answer this question.

Frank Weber:

Yeah, a good point, but I explicitly or we explicitly confirmed the 6 to 7% overall R&D by the way, as well as the 5 to 6% of Capex. So that's basically all in figure that we will always disclose, that we will not open up several buckets for this. So the answer to your explicit question is yes, we have of course in the other businesses which are not greenfield, we should see over time certain reduction of the R&D ratio for those, and if we add the others, we will still stay in that range. So you don't need to adjust the range, it's just that the others would be, and this is then in the bucket of operational excellence and cost improvements

[01:37:00] they're baked in, that we see in the other businesses a certain relief on that R&D side over time. But overall, we can keep the six to seven and the five to six even with those greenfield initiatives.

William Mackie:

Thanks. A point of clarification, sorry, if I heard you right, Marc, did you say that you expect to have closed about ten Priority A M&A targets in 18 months?

Marc Llistosella:

No, I said some of the ten and there's more than ten, will be closed in the next 18 months. And some of them unfortunately will eventually be a little bit more hanging.

William Mackie: Sure, thank you.

Marc Llistosella:

The main message of this is, and I would like to make it clear from the page 20 and 21, you could say, "Oh, now they're very, very rigid. They are very, very rigorous. And **[01:38:00]** do we think that there is any asset on the market which could really fulfill this requirements?" This for me was also the question, or will you be doomed only to organic? The thing is, even with this relatively written, very clearly outspoken criteria, there is a potential for A targets means that in the process we have already scanned the market and we found something which is equivalent to 1.2 billion. But we have also B targets which are equivalent to much, much more. So the topic is even if sometimes more exhausting, it is possible. There are companies, very good companies, very good assets on the market, and you can imagine that also in Germany there's some companies, it's not only that we are going out of **[01:39:00]** Germany and this makes the whole thing possible. So by having this kind of rigid criteria, you can proceed with unorganic growth. That's the core message. That's what we want to say. Because otherwise, eventually you would conclude and say, "Oh, they're now so on the margin, they're so on the profit, they will not grow." No, that's not the case. We will grow organically, but we will also grow unorganically. What we try to avoid, and you know it better than us, there will be always a failure also in the future, even with this criteria, there will be problems of course, but the thing is we have to be faster, we have to be more quick in realizing when we are the wrong ones. And we have eventually also to step away from a very, very promising asset. I think this is very important for the deal logic, because if you are in a deal and you know it, sometimes you're very, **[01:40:00]** very enthusiastic about the assets, what you're targeting, and then you forget your own principles and you say, "Whatever it costs, we have to have it." And that's exactly what we have to stop, this, we have to stop. And we have good examples of the past. I cannot name them, but you eventually guess them where we did this, and this was harm to the company, harm to Knorr-Bremse, and it was also not good for the assets we buy.

William Mackie:

Then as a follow up, as a question of maybe principle or the way you look at the business portfolio, you are leveraging your digitization capabilities or the technology development and your existing positions with the installed base to grow your aftermarket value or your aftermarket opportunity. But looking at the way technology is developing and also thinking about the strategies or the focus of your customers, the OEMs, what is it that stops **[01:41:00]** you in the future being disintermediated in the service segment by the OEMs also pursuing that value opportunity in your markets?

Marc Llistosella:

Uptime as a service. That's what we have to get there. The classical selling of spare parts is not the future. It is part of our business. It's substantial good part of our business. We are developing ourselves more and more in very, very, I would say technology services and solutions. When you see, for example, the electric power system, which we are starting, we have developed by ourselves like the automatic coupler, these are products which allow you a complete way of dealing in your business. This is providing you with data. For example, you can also argue that predictive **[01:42:00]** maintenance is reducing also the maintenance itself. Yes, you're right, but the customer is also paying more because he knows that he has an insured uptime. The insured uptime will be more and more the differentiator in our business. This is what we have to develop, this is where we have to go, and this is why uptime as a service, that includes the product, that includes the software-hardware combination of what we have and includes also the aftermath of the aftermarket. This together is making us valuable for the customer.

This is exactly where we can differentiate just to do a product, a braking system from A to B, this will be not the differentiator in the future. So we have to get more, and this is why we will invest also in this technology more. And this is why we also said that in innovation and R&D expenses, there is absolutely no way now to stop it or to reduce it for window cleaning, **[01:43:00]** for dressing for one or two years, this would be absolutely not the way to go. The way to go is we have to go more and more in combining the product and the services to one package, which is then absolutely understood with all marketable and also brings added value to the customer. I tried to give you some examples with the door system. The door system itself is a door, closing and opening and that's it. But the door system, when you have this kind of predictive maintenance, this condition monitoring in the door, then you have a chance to reduce downtime of the train. Downtime of the train is, you can use the train more intensively, you make a better business case to your customer and the client will be happy. And then you can say, "Yeah, but then you eventually have less maintenance on this specific door." Yes, you're right, but it's compensated by the uptime services which we provide with this kind of service as condition monitoring. Sorry for that, but I really love this topic. **[01:44:00]**

William Mackie: Very clear. Thanks.

Operator: And we have now one follow-up question from Sven Weier, UBS. Please go ahead.

Sven Weier:

Thanks for taking the follow-up questions. The first one is actually, when we think about the businesses outside the 1.4 billion, which 5.8 billion... How much margin upside do you see in those? Because I guess there is not a hard line between the 1.4 and the 5.8. 5.8 is perfect, no improvement needed. Is that then the focus for another day that you now focus on the 1.4 and then you take it to the next level and look at the other businesses?

Frank Weber:

You or me? Marc is smiling at me. I'll try it, Sven, thanks for asking that. So we are indicating on my last bridge, as you can see, basically the **[01:45:00]** two percentage points out of optimizing the 1.4 billion revenue bucket. And the other profitability improvements do come, so to say, from the other businesses basically, and it's not acting in sequence. We have holistically looked at the full revenue potential that we have as of today, and we've ultimately drawn a line between the 1.4, so to say, and the rest of the business system.

Sven Weier:

Okay, understood. That makes sense. The other question I just had was on coming back to the M&A side. I mean, when I look at the 1.2 billion potential, is it fair to say that whatever you do, it's unlikely that you're going to have a third division?

Marc Llistosella:

That's a good one. Tempting, tempting. **[01:46:00]** Today we have not any concrete plan to build up a third division, but by enlarging the scope of potentially suiting and profitable business, by enlarge the scope of our business, we have to be permanently aware that this is eventually both including, for example, the kind what I described as condition monitoring, as predictive quality and all that. That is RVS and CVS. This is both. And eventually a question would be the synergies. This will be more and more both. This will be data, and whether the data is coming from a train or from a truck is not that relevant. The relevance is what kind of business model you have, what kind of service you can do with this data. And here the question is, are we the best owner **[01:47:00]** in the current structure for this kind of services, or are we eventually having... We have need to adapt? That's the one enlargement of scope for the existing businesses. And the other one is, is there an asset which is interesting enough, and then it has to be big enough to be outstanding and own standing so that neither CVS or RVS should be the inclusive. So far we have not found, and I have to say this honestly to you, we have not found a significant asset of significant size because we shouldn't start then with 100 million or so, which could be in this role as an own standing business unit so far.

Sven Weier: Understood. Thank you.

Operator: And we have another follow up from Lucas Ferhani, Jefferies. **[01:48:00]** Please go ahead.

Lucas Ferhani:

Thank you for the follow up. So the first one is just on the free cash flow recovery. Obviously you highlighted the issues you have in China, India and as well as working capital. I just want to understand how you see the return to normalized level. Do you think from next year you are back towards 100% or kind of 80 to 90 coverage ratio, or is it going to be very gradual and only by 2026 you'll have a similar number of working capital base or how that part is going to evolve? And my second question is just on the digital automated couplers, you've talked a little bit about that before. Can you come back again on the size of the opportunity here, just that market level, what type of market share you could have and maybe as a percentage of revenues? I know you've had already a contract for automated couplers, what that could be for RVS medium term. Thank you. **[01:49:00]**

Frank Weber:

Lucas, thank you. Let me take the first part of it, and the digital coupler, Marc will do. So I would say it's fair to assume that it will not automatically jump back on the cash conversion side towards 80, 90% all of a sudden. There are certain elements in there that you have to wipe out over time and clean up over time. Even though some of the people in the market are saying that the supply chain issues are basically over, but not in all ingredients of the process. This is a fact. You still have stuff sitting in the books that you have only with a certain order book development then out of the system and sent towards the customer, invoiced and out of the books, so to say. That's one element. Also, inflation is a continuous fight with always kind of a certain than **[01:50:00]** mechanism, how to revenue in the end and get the prices passed through to the customer. So there might also be times where still a bit of inflated material sits in our book without having the price yet immediately. So it's fair to assume that it takes a bit of a time, but not too long in order to come back to this 80 to 90% levels.

Marc Llistosella:

Good. And Lucas, to your second question, what's the market potential? The market potential in Europe is roughly 12 billion for the automatic coupler for freight. So we would be a new player, but our aspiration would be very high because we have, and I think this is discussable for some, but we have a very, very, very good and very promising technical solution in this regard. So that means we are aiming at least 25% of that. Now you can say, "Oh, this is in a one-timer in a one year." **[01:51:00]** No, this is not, this will go over five to six to seven years because the reinstallment with existing wagons will not be that easy. Currently we don't have this capacity in the market. I don't speak about Knorr-Bremse, so this has to be first settled. But the programme itself would be in this range. Now the question of you will be, okay, is this an immediately accretive in terms of margin? It will be positive in terms of EBIT, but it will be not accretive in terms of margin level because also in coupler, the best is coming at the end or it's coming in lifetime is the aftermarket. So the aftermarket is coming normally after 10, 12 to 14 years. So it has massive revenue potential, it has, and it has a certain form of long-term profit potential. It's not dilutive in the sense of EBIT, but it is not accretive in terms of EBIT margin.

Lucas Ferhani: Thank you.

Andreas Spitzauer:

Okay. **[01:52:00]** Thank you very much for all your questions and your attention. We wish you a great afternoon and looking forward talking to you next time. Thanks and Bye.

Frank Weber: Thank you.

Marc Llistosella: Thank you.