Transcript of Webast and Q&A session of Knorr-Bremse's Q1 2023 financial results

Date: May 11, 2023

Andreas Spitzauer:

Good afternoon as well as good morning, Ladies and Gentlemen. My name is Andreas Spitzauer, Head of Investor Relations, and I want to welcome you to todays Knorr-Bremse call for the preliminary FY22 results. Today, Marc Llistosella, our CEO, and Frank Weber, our CFO, will present the results of Knorr-Bremse followed by a Q&A session. The call will be recorded and will be available in the IR section on the website afterwards.

Marc Llistosella:

Thanks Andreas and welcome everybody to our Q1 2023 earnings call. We appreciate you joining us today as we have to tell you something. Let's kick off with today's key take aways on chart number 2. An ongoing tough economic environment, especially due to inflationary headwinds, Q1 developed as expected: revenues increased significantly while EBIT margin was under pressure. We told you during our FY results, that from a financial point of view, 2023 will be demanding. But we are fully on track with our Full Year 2023 guidance which we confirm by today. All in all, demand in rail and truck is holding up nicely, which underlines the robustness of our business and the attractiveness of our markets. One of our current strategic priorities is to optimize and strengthen our portfolio. We have already made good progress in recent weeks and months: we signed the sale of a foundry from our steering operations in the U.S. and the Kiepe sale is doing good progress as well. I will provide you more details on portfolio optimization and cost reduction opportunities during the Strategy Update on July 18 this year. In addition, at this virtual event I will share our ideas for the future direction of Knorr-Bremse.

Let's move to chart 3. Especially in Europe and North America, underlying demand in the rail market remains strong driven by governmental support and the remitting push towards green mobility. Rail is the most eco-friendly mass mobility solution today and especially of the future. The elevated order books of our OEM customers and the translation into RVS's backlog are a clear proof of this. The market in China seems to be slowly but steadily recovering from two very weak years that were driven by economic challenges and the zero-Covid policy. The end of this policy is positive for all of us and the increased ridership is already showing a positive effect on our AM business. But the OE side will take some time to

improve again. At the moment, the biggest concern in the Rail segment still is the high inflation. As highlighted before, pricing in long-lasting OE contracts can hardly be adjusted. Aftermarket is easier, but we also have our important long-lasting relationships with the operators in mind. We do not want to risk them simply because of some positive short-term financial benefit. The truck market also faces ongoing good demand in Europe and North America. Truck production rates significantly increased in both regions in the past quarter and are also expected to be at least stable or grow slightly on a full year level. Overall, in terms of demand, we expect the first half year to be stronger than second half this year. Truck production rates in China in Q1 recovered significantly as expected. CVS benefitted from this recovery due to our leading market position and leading position in the field of technology, as well as our successful restructuring activities. In addition, there are good opportunities regarding content per vehicle, driven by the rather lower safety standards and the move towards innovative and reliable technologies also in China. Inflationary headwinds are also an ongoing challenge for the truck industry. We are confident to finalize the ongoing pricing discussions, so-called wave 2, with good results. It should enable us to achieve a positive price/cost ratio this year for Truck. I would now hand over to Frank for the financial insights.

Frank Weber:

Thanks Marc and welcome also from my side as well. Thanks for being with us today. Let’s have a quick look at the financial overview of Q1 on chart 4. Revenues on group level amounted to 1.9 billion euros, an increase of 14% year-over-year, driven by both divisions, which both posted double-digit growth. EBIT in absolute terms amounted to 192 million euros on Group level, an increase of almost 6% versus prior year - driven by CVS. This corresponds to an operating EBIT margin of 10.0% in the first quarter, 90 basis points lower versus prior year driven by RVS while CVS improved. Orders increased slightly by 3% to 2.2 billion euros in the past quarter compared to an already very strong previous year quarter. This sound development was driven by another strong performance in the Truck division. The very positive highlight of the quarter clearly was the strong order book which once more reached a record level of 7.1 billion euros. It provides good visibility and confidence for the months and quarters ahead.

Let’s move to chart 5. Capex in Q1 amounted to 64 million euros, representing 3.4% of sales. It is stable in absolute terms year-over-year, but lower in relation to revenues and well below our target range of 5-6% midterm. Net Working Capital increased by 270 million euros versus Q1/22. I will go into more detail on that on the next chart. ROCE for Q1 amounted to 16.3% as of March 31, 2023, which is slightly lower compared to last year’s level, given impacts from both profitability as well as working capital increases.

On chart 6, I like to provide more details regarding our Free Cashflow. It was negative as expected and came in at minus 199 million euros in the past quarter, but also an expected some 32 million euros better than in the previous year. Traditionally, our Free Cashflow is weakest in the first quarter and this year is no exception. The biggest impact on the development of our Free Cashflow still is the higher net working capital. One driver for this is that increased interest rates led to a deferred payment behavior and further increased accounts receivables among some larger customers. At the same time especially Asian payment patterns burdened us – meaning: building up accounts receivables starting already from January and carrying out payments very backend loaded throughout the year. In addition, we maintain a high level of inventories in order to be able to act flexible in response to customer requests and to ensure a high degree of supply security. Our "Customer First" strategy is a cornerstone of our long-standing and successful customer relationships and lays the foundation for our continuously good order intake as well as the basis for price increases. Free Cashflow in the coming quarters should improve driven by increasing profits and the reduction of net working capital in relation to the underlying business development. We strongly monitor Free Cashflow as our important key performance indicator, which represents the 20% of our Short-Term-Incentive, and we are convinced to improve quarterly Free Cashflow significantly and to reach between 350 and 550 million euros within the Full Year 2023.

Let's take a closer look at the divisional performance in Q1, starting with RVS on Chart 7. Order intake of RVS was again strong with 1 billion euros, despite tough comps year-over-year. Book-to-bill in Q1/23 reached 1.17. We are pleased with the high order backlogs of our OEM customers, which will be translated into orders on our books in upcoming quarters with - given the usual project timelines at OEMs - a time lag of roughly 9-18 months. Europe benefitted from increased ridership in the Aftermarket business, the acquisition of DSB in Denmark and from the strong metro business. APAC order intake developed slightly better, especially driven by China. The main positive driver in North America was Aftermarket based on a strong overhaul demand. The order book also increased by more than 20% year-over-year to more than 5 billion euros. This is an extremely solid foundation for the business development in 2023 and beyond.

Let's move to chart 8. Revenues in Q1 amounted to 855 million euros, an increase by more than 10% year-over-year driven by Aftermarket business which compensated a slightly weaker OE business, mainly driven by timing of project executions in Europe. All core regions developed generally positive: Europe, our most important market, driven by significantly higher Aftermarket business. North America also recorded growing revenues in the OE and aftermarket business. From a segment point of view both freight and passenger cars were up. Finally, we saw a certain recovery of revenues in China as well as an overall solid

development in APAC, which made up for the weaker business in India. The operating EBIT margin of RVS in Q1/23 was 13.1%, after 15.7% a year ago. On the next chart I will provide some more details regarding this development.

In the past quarter three major reasons led to the strong drop of profitability. First of all, missing accretive Russian business which was strong in Q1/22, but has been stopped on purpose since the second quarter of 2022. Starting from the second quarter 2023 this year-over-year effect will be gone. But for this quarter it finally led to 160 basis points profitability drag. Secondly ongoing inflationary headwinds that cannot be compensated as quick as in truck for example. As mentioned before, the characteristics in rail are different and we will suffer from a negative price/cost ratio in Full Year 2023. Higher input costs can only be partly offset by the higher prices in the Aftermarket business. Please keep in mind that 30% of our 2023 RVS-revenues stem from order books we received before the inflation started to strongly increase last year. Thirdly, in the past quarter, there was also a weaker mix in India, resulting from lower revenues in the very profitable segment of "passenger coaches".

These three negative effects were only partially offset by improved volumes and our PCPP program measures. As a result: in the quarters to come, we should see better margins supported by higher revenues and the operating leverage as well as by our PCPP measures. In addition, the planned sale of Kiepe should contribute to this development. Nevertheless, inflationary cost pressure will continue throughout 2023. And as mentioned, for the Full Year 2023, we expect RVS margin to be lower than previous year, especially given the delay in pricing.

Let's continue with truck on slide 10. Incoming orders of CVS amounted to 1.18 billion euros, which is an increase of 14% year-over-year, well supported by the strong underlying demand in Europe and North America. We are pleased to see that China is significantly recovering as expected. Please keep in mind that the extremely high order intakes in recent quarters are extraordinary and should not remain on such high levels throughout the year. We expect that the truck demand in the first half will be stronger compared to the second half. The Book-to-bill ratio in Q1/23 was at a very strong 1.12. The order book of our truck division amounted to almost 2.1 billion euros at the end of March 2023, which is again remarkably 14% higher year- over-year.

Let's move on to slide 11. CVS posted over 1 billion euros in revenues in Q1 – which is a significant increase of almost 18% year-over-year. Again, a very strong result. CVS saw a positive development in both channels, OE as well as Aftermarket, including an increased development in all regions. Transport volumes

and infrastructure activity have continued to be solid in most markets. In combination with the customers' need to renew aging fleets, this contributes to the good demand for our products. Despite the strong OE growth, the Aftermarket share remained stable at 28%. CVS should also be able to further post solid revenue growth in 2023. This positive outlook is founded on the strong underlying truck market, especially in China, and the elevated order books. In Q1, CVS achieved an EBIT of 95 million euros, which is a significant improvement year-over-year of almost 25%. The EBIT margin amounted to 9.0% compared to 8.5% a year ago. This improvement is fueled by the first wave of prices increases which were concluded in 2022. In addition, cost measures and the acquisition of Cojali contributed positively. Profitability of CVS in the Full Year 2023 should continue to improve as we expect each quarter in 2023 to be slightly above the prior-year figure. Overall, CVS should be able to offset RVS's margin decline this year.

I want to finish with the guidance for 2023 on chart 12. Our main assumptions are outlined on the right side of this page. We also expect that all net extra costs due to inflation this year will be once again compensated with our PCPP measures.For 2023, we continue to expect revenues between 7.3 to 7.7 billion euros, an operating EBIT margin between 10.5% and 12.0% and a Free Cashflow between 350 and 550 million euros. Despite rather weak operating margin levels in Q1/23, we are fully on track with our full year guidance. The worst should be behind us and Group margin levels in course of this year should sequentially improve. With this, I hand over back to you Marc.

Marc Llistosella:

Thank you, Frank. Let’s go to page number 13. Many different economic and geo-political topics continue to weigh on our business activities and profitability level. Please be ensured that the Executive Board and all employees are strongly committed to fight these headwinds. For the Full Year 2023, we expect another 300 million euros of net extra costs in our books on top of the prior year’s 2022, 325 million euros. Just as last year, we expect to fully offset these extra costs with price increases and cost measures – which will show the positive impact with some delay though. We have already successfully implemented efficient restructuring measures in North America and in China to reduce fix costs. The restructuring of our steering business is also ongoing - with the first step of the sale of the foundry at Sheppard. We will continue in the next month. Please be sure that there is more to come. We will share more on these concrete topics at our strategy day in July.

On chart 14, I would keep you updated on our and my agenda. Onboarding thanks to the whole executive team was very smooth. Overall, I am really impressed by KB’s people and their engagement and dedication

and competence every day. The executive board gets along very well and we enjoy maneuvering Knorr-Bremse through these extraordinary times together as a strong team with fruitful discussions based on open mindsets. We have started to work on a common target picture for Knorr-Bremse in order to create a long-term vision and a return to profitable growth. Portfolio review, the improvement of our fix cost base and the roll-out of further efficiency measures remain our core operational focus in the months ahead. We call this “Brown Field” or I call it housekeeping. Together with my colleagues, I am currently conducting a strategy deep dive, looking at both the current set-up but also identifying new potential growth areas for both divisions as well as potential accretive add-ons that could fit Knorr-Bremse’s business structure and DNA. This represents our “Green Field”. There are many opportunities and believe me when I say that we will turn around every stone to find out how to improve, sharpen and accelerate our business. First results will be presented at our virtual strategy update on July 18. And with this words I would like to thank you very much for your attention and let’s start now with the Q&A.

Q&A Session Knorr-Bremse AG

O Operater
ML Marc Llistosella
FW Frank Weber
AS Andreas Spitzauer
SW Sven Weier
WM William Mackie
GB Gael de Bray
LF Lucas Ferhani
CC Calvin Chan
MZ Marc Zeck
AG Akash Gupta

O

Ladies and gentlemen, we will now begin the QA session. If you would like to ask a question, please press nine and star on your telephone keypad. If you'd like to withdraw your question, press nine and star a second time. The first question comes from Sven Weier, UBS, please go ahead with your question.

SW

Yep. Good afternoon, it's Sven from UBS. Thanks for taking my questions. The first one is just to follow up real quick to help us to frame our expectations for the 18th of July. Should we also expect you to talk

about mid-term margin targets at this event, or is it going to be mostly focused on actions for the brownfield? Just wondering how comprehensive the agenda will be for the day. Thank you.

ML

Thank you. I will take it. What you can expect is a clear view in terms of products where we want to go. We will give you not absolutely imperfection which kind of portfolio we have, which our target portfolio will look like because otherwise we spoil the targets which we will eventually acquire. But the adjustment of the portfolio will be one of the major information what you will see on this day. What we will also say is, that we have an organizational I would say overmatch here or we are over organised. Currently, we started with 146 legal entities and by your own organisation the more legal entities you have, the more SG&A cost occur, and the more complexity you have, the less focus we are. So that means currently we have deducted it already to 126 organisations and we will go further and there's a clear target which has to be achieved. So this kind of messages relatively clear will be given. What will be not given is which kind of target assets we have in mind.

FW

For sure Sven, we will also head to the financial direction which we target going into the future as well.

SW

Thanks for this. My second question is just on talking cash flow, and you mentioned again some payment delays in India and China. Could you just kindly update us on the situation [22:00] with the Indian customer where I think there was some tech issues on the freight side, where you stand on that and if that's behind the delay in India? And also, more broadly speaking, you think that you also have to identify further self-help measures on the cash flow side that you could update us on in July, or do you feel you are on track with the measures you have already taken? Thank you.

FW

Yeah. Thanks Sven. I assume you are referring also to the news report that you've seen which is one incident of course. These kinds of incidents happen in the rail industry globally not only in India and with elements of trains where we also supply products towards or is normal course of business. In this case, we are in discussion with the [23:00] Indian colleagues. We talk about how to fix the issues that Indian rail has with their wagons. Please be informed that we are not the complete system providers, so we're just delivering some components there, so we are part of these discussions and that the solely sky on the table that is somehow being blamed, this is not the case. We're in good discussions, but it led to the situations that they have also been withholding some payments in regards to AR, they have now released the payments again starting with May. So, this is a good sign, we're in good talks with them and this should definitely contribute then positively for the cash flow development throughout the remaining months of '23. [24:00]. This element of your question the more general, yes, we have several levers at hence that we are pursuing. We of course strive for inventory reductions which is one big element in the respective assembly plans that we are having. We have a detailed plan of what needs to be achieved in each and every month in order to take now the situation where revenues should be increasing going into the new year in the months to come. We should take this tailwind of being able to bring then the scope

of days down for inventories which is a measure this is with the operational experts and procurement in combination underway. Second lever is of course, claim management improvements that we are driving within the company in order to bring accounts receivable back to the levels where we want them to have and to bring more discipline [25:00] to the customer's payment behaviour. Of course, this is not always a lever that you alone have in your hands. You also need to have the customer understand it and be willing to pay in the end. So I would saythose are the big levers that we would have and of course we will give you in July also an update on that where we stand and what we perceive as our path forward in regards to working capital management and ROCE.

SW Thank you. I don't know where we limited to two questions or can pendle in another one?

AS Maybe later as the third question.

SW Okay, that's fine. Will do, thanks.

O Then we come to the next questionnaire. The next question is from Akash Gupta, JPMorgan, please go ahead with your question.

AG

Yes, hi. Good morning, everybody and thanks for your time. My first question is also on the event on 18th of July. I will keep [26:00] the details for the day, but I'm just wondering Marc, if you can walk us through the framework that you are using for portfolio reviews in terms of what are the KPIs that you are assessing each of the business unit and what should we think about the level or amount of assets that could potentially be reviewed which needs to be turned around either way or maybe set for disposals. That's question number 1. And the second one is on your policy of writing down receivables. I see you have some receivables which are overdue for quite some time. Can you walk us through what is your policy on writing down receivable? And also, can you tell us the quantity of these receivables which are deferred since quite some time? Thank you.

ML

So, thanks for the question, Akash. I will do the following, [27:00] otherwise the 18th will be absolute if I'm now coming too much into details. I understand your curiosity on it. I would love to give you now already some of my deep thoughts on this but I am warned here not to do that otherwise nobody will show up when it comes to the 18th. I give you only one response to the portfolio. We have currently roughly 1.4 billion of revenues where we have a deep dive in terms of revenues of last year where we have a very clear direction, either it has to be fixed in a reasonable timeframe or we have to make a very clear decision. That's all to the topic of portfolio. And the portfolio by the way derives also from the target picture of products. You have always to know where do you want to play, and then the question is what you play, [28:00] how you play? The second question which you raised in terms of accounts receivables, there's one comment I would like to make and then I will tie over to Frank, because otherwise he's very mean if I get into his territory, you know that. He's very, very protective here. The thing is, and that has to be also something which we call now active expectation management. There is a change and the change is, especially with China. China is very aware, especially in rail, what position they

have worldwide. They're combining roughly 40 to 55% of the global market annually and this is one country and they know that everybody wants to play in the field, and this is what they use. So, their payments in terms of duration when they pay it this is something which we could observe not only with us, also with other companies everywhere in the area [29:00] where we see that they exceed by far the normal payment terms and that is something where the question is also to you, how you could imagine to change that when the key customer of the world is just doing what he likes to do. That is something which we have to live with this very generic, more philosophical point of view, I will hand over to the terms and the conditions of our accounts receivables to Frank.

FW

Thanks Marc, of course not everything you said I'm not getting mean now, so everything. I appreciate if you take over parts of the question. So, **[29:42]** the more seriouselements, what Marc said is absolutely right. Akash, we've been talking about this since at least I'm with Knorr-Bremse, that the payment terms in Asia are much longer than the ones in Europe [30:00] given our revenues that we are making in Asia. This ends up to a 300 million plus overall of accounts receivables that we would be having in our books with longer payment terms than the average that we see in the business, so there's a general drag always throughout the year, andpayments come in usually very late in the fourth quarter. You know that pattern and yousee it always in in our free cash flow development. The explicit one second element of your question, Akash, the explicit elements that have been somehow delayed more recently are slightly above €100 million in quarter 4 and we still represent the track in the first quarter and where we are getting now partially releases. But be assured Akash, we have not a single euro [31:00] right at this point in time and not in the past had of general defaults, just that you know that.

AG Thank you.

FW You're welcome, Akash.

O The next question comes from William Mackie Kepler, Cheuvrex. Please go ahead with your question.

WM

Thank you very much. Good afternoon to you both or all. China, can we just dig a little bit more into what your observations of a recovery for RVS in the first quarter and perhaps some of the signals that you are receiving from your customers about expectations on build rates or fill rates for the aftermarket business going into Q2, Q3 and building on how that will [32:00] support RVS? The same for trucks, we started with an assumption of about a market for 750,000 units in China. As a base, where do you see that evolving for this year? Thanks.

FW

Yeah. Thanks, William, for that question, let me start with rail. So, first of all, our head of RVS Jürgen Wilder needless to say, being always very close to the customers. He was over in China just several weeks ago and we have been seeing photos of the production hubs of one or two major plants of our core customers, and they were completely empty. So basically, underlining also a bit the hope of a very

speedy recovery in regards to the OE market development through our 2023. So this was really [33:00] interesting to see that really the plants are empty. OE business we therefore expect only a slight increase in demand throughout the year with the borders to come. It should start kicking in rather later in the year 2023, but only on a slightly improvement basis in aftermarket ridership levels are really good. The maple levels have reached in the first quarter already the ridership levels of 2019 so the pre-COVID levels on the high speed and commuter side it's slightly below the levels of 2019 but overall, this is a really good indication and should support us going through into the year but aftermarket, not immediately coming in first of all [34:00] ridership levels increase then the number of trains on the tracks increase, then those trains running reaches certain level of mileages and then they come for maintenance and overhaul and wear and tear of course starts.

FW

In general this should help us as the year goes by and the months goes by throughout this year in aftermarket more than in OE. We expect for Metro some 5,300 vehicles for the full year, which is a minor increase compared to last year's level of roughly 5,200 Metro and in high speed roughly a 100 high speed trains compared to last year was around 90, so only a slight increase there as well. On the truck side we do see market for the heavy duties. Only this is the figure that you are referring to [35:00] of above 700,000 but we are still a bit cautious. It's been a good quarter 1 with 17% TPR up for trucks but we see some 700,000 plus potentially not that bullish like some other players in the market rather take then the tailwind once it really comes along. We are seeing a good TPR development in the first quarter and we are hoping also for a good second half of the year than in China, but across the bridge once you reach it I would say towards June we see clearer.

WM

Thank you. Then my second question, and then I have a follow-up relates to the inflation slide, which you highlighted on page 13. You call out 300 million of incremental cost against the [36:00] 350 last year but when we look at the world, a number of those inflationary factors are now reversing. So, can you help us perhaps a little bit with your working assumptions around how the 300 headwind breaks down and how perhaps it's changed from last year through the supply chain or other factors on your raw material energy or component costs?

FW

Yeah. Thank you. Good question. Indeed, so in order to be precise, the last year speaker was 325 million. This year on top there come another roughly 300 million. They are fundamentally completely different when it comes to the ingredients. Will not talk again about last year, but this year it's basically driven by energy cost increases and [37:00] personal cost increases. Those are the two major drivers in '23, in the wrong direction. In the positive direction, there's raw material this year but to a large extent of course, as I just said, offset by those other two elements. Right, raw material indices if we look at the bigger ones coming down, cast iron steel coming down, aluminum coming down, coke coming down, plastics coming down. Of course, we have to watch that carefully, but what needs to be said in regards in order to prepare your production for the year 2023 you have to ensure a certain lead time, and that lead time also means you have to have your inventories, your raw materials, your half finished goods you what have before youstart selling those on board, which means that [38:00] you are still with the time lag

behind in regards to the cost inflation. In our working capital, good sitting and raw materials sitting with cost levels of the year 2022, needless to say. This is one effect why we are not completely yet seeing a full spot rate reduction that you would see if you look at indices.

Overall, in general you are right that the raw material should be at minimum what for us it should be a tailwind, but the big chunk comes from energy, and with energy you have to distinguish between our own energy cost that we are having which is still in a double digit million range only. The total energy cost of Knorr-Bremse group are still below €100 million euros. This inflation [39:00] or the cost increase that we see here is some roughly €20 million year-over year, but the big element of those 300 is according to our estimates, the amount that our suppliers, tier two, tier three, tier four, knock on our door and ask for material cost increases because you would have in the supply chain. Of course, a lot of energy intense sub-suppliers in the system and this is the big chunk of what we expect. Then the next big chunk is personnel cost. To round it up with roughly two numbers, I would say roughly 150 million to 200 million out of that which stem from the supply chain as energy cost increases and also personnel cost increases on the supplier side. [40:00] The remaining, I would say 70 million is the big chunk of personnel cost on our premises around the globe, and there are some other minor cost increases then, but those are the two biggest elements. Long answer, I hope this gives you some more insights on this figure for you, William.

WM

Great detail. Very useful for us all. Thank you. The last one is perhaps quick. I note that in your statement today, you highlight that there is now an establishment of the Thiele Family Foundation, after long waiting but there's also a clause at the end that you received a claim from a bequest concerning 59% of the equity. First of all, just to clarify maybe the translation in the English text what that means, but more importantly can you share with us. Your understanding of the foundation's intent [41:00] longer term with its portfolio, and particularly with the KnorrBremse share?

ML

I assume this goes to me. In regards of the foundation last time when we met the question was what is your governance? What's your structure? Now we are settling the structure, we have now all the positions placed. I think you heard this morning that although the supervisory board of the Stiftung is now settled. We could gain an excellent candidate an EX CFO from BASF, he's taking care of that. We have also now the chair of the executive board of the Stiftung with the storm, so now we are settling the whole thing not only that the foundation is founded. I think this was first week of April, now we have also the people who are running it. This is number 1, that's good news for us. Number 2, the first exchange we had with Mr. Sturm and also with the other colleagues of his, is very clear they're very interested in keeping their position as it is. There was no indication at all, that they have any form of change in the strategy or the shareholder. Number 3, they represent 59% of the shareholder ship of Knorr-Bremse. So that means 59% of the 162 million shares are represented and hold by these guys or by this foundation. So everything else, what is now their plan? Is there any change to come? We are not sitting there. So for us, it's of course an important shareholder, but we are not involved in their thinking and thought [43:00] processes, but we have not at all any indication that they want to change anything for the time being. More, we can't tell you.

WM Super, thanks for the clarity, Marc.

AS Yeah. Thank you. Let's come to the next question please.

O Yes. The next question comes from Gael de Bray, Deutsche Bank. Please go ahead with your question.

GB

Oh, thanks very much. Good morning or good afternoon. Can you talk a bit about the portfolio review and the €1.4 billion of revenue that is the subject of a deep-dive at the moment? Is there any way you could help us understand two things? First perhaps the average profitability of [44:00] this €1.4 billion of revenue and second the magnitude of the potential restructuring spends and impairments that could come out of the process? So that would be question number 1.

ML

Okay. Again, like I said to Akash, I should be fair if I tell it you then Akash will never talk to me again, so I should be careful now. Question understood, the thing is, the criteria to get into this 1.4 bucket is a non-performance in terms of EBIT for the last five years. That's the criteria number 1. The second criteria for getting into this 1.4 is that nobody could really, really prove that there's cross-selling really happening because that's an explanation that could be an excuse for your non-performance in terms of EBIT line that you say yeah, because we are contributor in a different way. By selling us or by getting our product to the customer, we can do other business which is very profitable. If this is the case, we call it profitable cross-selling. If this is the case, you have an excuse, we evaluate the excuse, but it will not last forever. And number three is, if the non-performing, whatever it is, unit, product, product group, is there a plan by the management to recover to EBIT levels, which we aim and you can imagine everything what is not double-digit has a very difficult life today. That means if you don't come up with an internal business plan and convince us. We will [46:00] not come up and convince you so it's very simple, we will be the first cascade to make sure that this kind of business plans which are not prepared, we want to see it and you are even more rushing than us because you clearly told us everything Marc what is not coming in the next 24 to 36 months we're not really interested and of course you can understand some of them they're coming with 60 months of duration and long-term supervision and reviews. Long story short, these are the criteria to come into this 1.4. The 1.4 is dynamic. If they come up with a very convincing business plan in the next weeks to come, it'll go down eventually to 900 or one, or it go eventually light slightly up. And next question number four is, what would be if you would already do what you are aiming what will be then? What is the effect? In terms of revenue, [47:00] the effect is clear it's just a deduction, but the alternative is always for A, keep it and fix it, but fix it within two to three years, don't tell me five, 10, 15 years, forget it or exit it. Now you understand. If I want to exit it, if I tell this too straight and too clear to the market, nobody ever will buy it. So that means I can't in the interest of you as a shareholder give you the information as an interest of an analyst, because then the thing which we identify is unsellable. So, we can give you slightly direction so we can tell you what effect it'll have but we cannot give you a list of names that say A, B, C, D, E. The only thing is what we can say so far, the effect is really interesting in terms of 200 to 300 basic points**,** ceteris paribus. So that is very interesting and you understand why [48:00] I'm so keen to make this kind of portfolio discussion and adjustment because

without changing anything, we can go in this direction but we have to be very stringent, we have to be smart and we have to be in time tech, it is a sequence which has to be following a logic. So hopefully, I know it was vague and Akash, you can blame me later that I gave you not this information but you understand exactly because your portfolio managers how you want to do it. You don't claim what you sell tomorrow.

GB

Yeah. Fair enough. Look, I have a second question related to RVS. What is the share of your backlog today that has escalation clauses and is it becoming more of a norm now in your building processes and in the pipeline and how do you expect this share [49:00] of the backlog within big session closes to evolve over time?

ML Yeah. Frank, you want to take that?

FW

Yeah, I take it Marc. We already had in the times before the high inflation kicked in last year already more than 50% of our contract in rail with price indexation clauses or with price sliding clauses so to say. As you know, alone 50% of our business in a nutshell is anyhow aftermarket driven. We also have elements in the OE business which are much more product business oriented and see project business that you would usually see with the big OEs in Rail which is the freight business, a big [50:00] chunk of the business also in rail already followed back in the days a similar logic like the product business. So, we have a big amount which we extended. The colleagues over the last year were able to improve the number of contracts with price sliding clauses, they were even able to improve and include further elements into the price sliding clause, make them stricter and those were good results that have been achieved in regards to the quality of the underlying contracts and the systematic approach within contracts, how to tackle inflation.

They have done a good job on that. Nevertheless, the situation remains tough, especially when it comes to OE contracts to further improve them. Of course, order intakes that are coming in are having [51:00] now the actual cost in the price calculation so the really good news is that the newly incoming order intakes are really with a good profitability that is the good thing. And as Isaid also in my speech please keep in mind that we have had last year, end of 2022, an order book of roughly 5 billion for rail out of which roughly 1.8 billion do come from orders before the war which leads to the situation that again, said before, 30% of our revenues in 2023 are bit burdened for those contribution margins, and this amount will significantly shrink going into the year '24 then basically be wiped out towards [52:00] '25 only a minor element will remain then in '25 and that is also the reason why we believe in increasing margins in the rail business, giving that effect loan.

GB And just out of curiosity, this 30% of revenue is it rather linear or was it a much higher number in Q1 for example?

FW

That should shrink roughly over time. It should be a bigger hit in quarter 1 and then shrinking towards year-end and in 24 similar.

GB Thank you very much.

FW You're welcome.

O The next question comes from Calvin Chan, Credit Suisse, please go ahead with your question.

CC

Hi, thank you very much for taking my question. [53:00] I've just got a question on your pricing. So you mentioned the company is establishing a mechanism in terms of pricing for the rail division I'm just wondering how is this process doing right now? And also, in terms of numbers should we expect say, 3% or still we should expect below 3% for pricing for rail this year? And also, follow up on that, your sales going into a customer chasing for price increase, will that affect your payment terms or cash payment terms for the profile of your business, please?

FW

First of all, just to make it clear, Andreas, I think we didn't say, we now introduce this systematic link between inflation and prices for the first time in rail we are improving it. I said before, we already had [54:00] price sliding closes before high inflation kicked in and we're now improving it as of course the pressure rises so first of all, I think that's important to mention. Second point is, we have also said that we will again in '23 overall be compensating the inflationary costincreases with 300 million, and we also aim to achieve a balanced cost price ratio throughout the group at least in 2023, so that means we should also find in a similar direction price measures. And therefore, similar like last year, two third of those price measures will be implemented in the truck division and the third in rail and if you take a third out of roughly 300 you [55:00] end up at 100 million and in the end, you are not far away with 3% that you grossly indicated, so I can confirm that this is the year over year figure that we are aiming for in the rail division to achieve. Can you please help me out on the last element of your question or the third element of yourquestion was Andrea?

CC

Yeah, it's actually Calvin here. Second part of that question is when you go for price increase to your customers. Would that affect their demand on the cash payment terms over the short-term or midterm?

FW

No, we don't expect that. We have not given in over the last weeks and months on any kind of payment terms in any negotiation or pile prices.

CC

[56:00] Got it, thank you. And also, my second question is related to the working capital and cash, so you have around minus 199 free cash flow for Q1 and then targeting 350 to 550. And also, you mentioned Q4 has affected Q1 so if we think about Q2 in particular the cadence, do you expect a deferred payment by your customers in Q1? Do you expect to collect them in Q2 or that's more of a gradual collection throughout the year? And also, how will Q1 affect Q2 free cash flow, please?

FW

First of all, to the general pattern topics that I mentioned before, the more Asian ones this is rather a more back end loaded quarter four payment behavior that we would expect so it would not ultimately [57:00] turn into cash already in the second quarter, first. Second, to the more explicit element we talked about the discussions in India. I expect at least partially relief in the second quarter already whether to the fully extent I doubt a bit but as negotiations are always longer lasting so maybe in the ultimately done via the third quarter, this would be the expectation. In general, we expect free cash flow in the second quarter not to be significantly better than in the first quarter but not positive, then third quarter positive and fourth quarter, very good so to say, this is somehow a rough indication of how it should go throughout the year.

CC Got it. That's very clear. Thank you very much.

AS Thank you. [58:00].

O The next question comes from Lucas Ferhani, Jefferies. Please go ahead with your question.

LF

Good morning. So, my first question is also just continuing on working capital if we think more on a medium term basis, historically you were doing 45 to 50 days, and that's also the target that was set on the medium term. Do you see a change here in terms of what you can go back to, given some other changes you have in your portfolio and your regional exposure? Yeah, that's the first one.

FW You were talking about your estimates on scope of this, right, Lucas?

LF No, that's the target that was set in your prior medium-term presentation **[58:46]** 45 to 50 days for the working capital.

FW

Understand. Yeah, the guidance that we have been given there for the midterm was obviously at times [59:00] before the China market dropped, before the Russian war over Ukraine and definitely before the high inflation ultimately kicks in. So, we do think that in very general, we stick to that kind scope of days targets going into the future, but with adjustments for of course inflation, because inflation kicks in AR and in inventories as well as in payables and we are currently working on all those impacts, how they would impact those targets midterm. Secondly, we have to take out our scope of days for Russia as this

we don't plan with Russian business anymore. So those three adjustments, basically need to be done. Fourth element is of course, [01:00:00] but we have to react over time quite flexibly. We of course see as you also see with other companies that a bit the OEM behaviour in regards to what they expect from the suppliers when and to which extent to deliver, there might be slight adjustments in the general business model between an OEM and the supplier when it comes to work in capital and to have your product at hand and this we will adjust as well. So I can't give you the concrete figure as of now, we will do so by July what we target here but expect those three and a half adjustments to the prior figure that we have had. Don't necessarily all go into the same direction, there might be some pluses and some minuses just to say that.

LF

Okay, perfect. My second one is on [01:01:00] pricing in CVS. Do you think that could be more of an issue in a tougher volume environment in H2 to ask for further price increases? And also, just in your guidance for the positive price versus cost by the full year, is this mostly driven by kind of carryover of pricing, or do you need to have further price increases and further negotiation in CVS?

ML

In fact, it's two questions not one. The one question which in regard is how is our pricing position when the volume increase in the CVS market will no longer last? It's very clear we have here currently price-cost ratio, which is more, more getting favourable, that's for sure, number one that's for this year. Assuming that the market will go down globally, [01:02:00] then of course we could see two effects. The one effect is that the positioning, what we have given us is now based and integrated in the contracts, which is absolutely in our favour. So, if it comes to real decrease of the market, we will have a certain form of delay of this effect in our profitability as we had it with the inflation. This is the same what comes so it's always something like a tailing.

However flexible you are. You have this in the bad side, but you have it also on the good side. So, on the good side is if the market goes down, the question is, is it going down constantly or is it just a slight dip? For a slight dip, we will not see any infect on us. If it's a dramatic decrease for example in China. We have in China seen and that is something [01:03:00] which at least I can refer to and hopefully this gives you a response to your question. In China, we had a collapse of the market from 1.5 to 1.6 million trucks in 2021 to a market which came down to 650 to 700,000. Still in this market even it was collapsing by nearly 55%, CVS was profitable in China. So that means, yes, we are hammered but we are not hammered as anyone else because first, we have a contractual base which is lasting, and second, you need us. And that is the very, very good selling proposition which we have. That's the good thing with claw, you cannot just substitute us, and in rail it's even worse or in price of the customer even better for us because to exchange our system is not possible. So this [01:04:00] is the strong message than also for this year and for last year. Even by having increased the prices in some cases by more than 27% steering Japan, where customers had to accept it. Now you can say but then when it is so easy, you could have done it. We have to be careful because if you are too strong on this point and too general on this point, it could happen that some customers especially in rail, they just consider and say, listen, if this is the consequence of our dependency, we make sure that the dependency will not last any longer, it's a walking on the line. In trucks, it's very clear we have a competition there but also the competition is very, very interested to bring up the pricing system and to keep the pricing level, especially in Europe and

America, we see no deterioration of pricing at all, not even when it is going down. What we can say is, in China, there is a tendency that more and more local [01:05:00] suppliers are trying to get into the market. So that's the answer to the question number one. Question number two was? Can we just rephrase that?

LF

Yeah, if you need more price increases this hearing trucks to cover inflation or it's just mostly carried over from what you have already negotiated and agreed?

ML

It's carried over and this is, we call it the Wave 2. And we announced it even with our big customers with Volvo, with Traton and with Daimler but it is not generically done, everybody gets the same, this is on the customer specific. But there was a first Wave 1, and now we are ongoing Wave 2. And this Wave 2 of course gives us better results because you could say, and I'm pretty sure you did already the math and said, "Oh, very good organic growth, but the organic [01:06:00] growth was not that super profitable." And that is still the effect of the inflation and still the effect, but this diluting effect, we will see less and less by quarter to quarter to quarter. Mr. Spitzauer now looks very angry on me, but I can tell you that in 2024 you see RVS nearly adjusted from this dip and then you see the real profitability level of this dip because all the time we have to discuss with you, we have to explain, we have to excuse, we have to show how the inflation is absorbed. In the end of the day, '23 is a transition year for RVS, it's a recovering and it's a transition for RVS. '24, assuming that you see no other horrible events in Asia, for example, then [01:07:00] we can say the contract that have all inflationary numbers included, the cost cutting effects are also included so this is very promising then for RVS in 2024. We see 24 internally as a clear recovering year for RVS and we are working on that to even uplift this effect with some portfolio adjustments. In CVS, I would saywe are at least three to four quarters ahead. Here we see the effect faster coming into the game, and here we see eventually also quicker than expected, the portfolio adjustments coming into place.

LF Perfect, thank you.

O The next question comes from Marc Zeck, Stifel. Please go out with your questions.

MZ

[01:08:00] Thank you for taking my questions. First one, just a quick clarification also related to the July event, you said that 1.4 billion of revenues are under review, I guess during the full year results you said that 10% of the portfolio is under review and if I'm not totally wrong with my calculator, 1.4 equates to more than 20% of the portfolio, so did I get that right that the amount of revenues here are currently considering has just doubled within like two months or so? Yes, with me the first question.

ML

Thank you for the question. For your calculator, you take please the assumed revenue of the year2023 which is assumed to be in the range of, let's say 7.5 billion. From the 7.5 billion we take a really close

deep dive with 1.38 billion. So, you're right it's no longer 10%, it's closer to the 16%, number one. Well calculated. Number two. It's dynamic process. So, what we see is red, yellow, and green. This is how we cluster the whole product and company portfolio of Knorr Bremse. Everything what is not a contributor, it's a diluter in terms of EBIT is in the red. Everything what is not to our extent of EBIT Margin is in the yellow and everything what is either on the line or above the line is green. So, you can imagine that the 700, which I spoke at the very beginning when we met, this is the red and it's very dark orange to red. What is now additional to that is in the yellow. [01:10:00] So this is where we say, can we fix it or do we have to exit it? That's by the way. The third option, do we have to do a strategic partnership with someone who can massively help us to get this business back or eventually on the level which we wanted it. So this is in terms of the accuracy of the numbers, hopefully this is now understood.

MZ

Perfect, thank you very much. second question would be on CVS, and I guess referred from some European OEMs and tracking space that they saw an uptick in order cancellation in trucks not a big one, but let's say an uptick from no cancellations previously. Can you confirm this that you've also seen this, and this is also true for non-European tracking OEMs? That will be question.

ML

If it's fine for me, [01:11:00] I would like to take it because trucks, as you know is my territory and even Frank agrees with that.

FW I do.

ML

What we have seen last year was an exceptionally run, especially in Europe and America on trucking production slots. This is very common in America because there we have a cyclicality of the market which is exceptionally high 30%, 50% up, and then next 4 to 20% down. So, the Cyclicality leads to a certain form of purchase behaviour. The purchase behavior in America is very, very similar always over the last 30 years and we know it also from Freightliner. Then when something is a rush, everybody wants to get a production slot and they just cover it to take it, whether this is then a binding or a really binding purchase especially in America, it's not the case so the cancellation here, the up and go, this is normal business. This is why you remember when the numbers were so significantly up in the quarter 4 and quarter 1 last year and this year, we were always a little bit decent and modest. We said, the markets are good but we don't want to celebrate it before it comes to real execution. In terms of Europe, we see one thing and we said it also. We see that the trailer market, which is not really correlating to the truck market, not really correlating So you can't say if this goes down, the other thing goes down also only with a delay of three or four months. But the trailer market is relatively modest, by the way, in China it's the opposite. The trailer market in China is extremely bullish. In Europe, it's very modest and slightly going down, and this was always for us a reason why we said [01:13:00] whatever kind of orders we see with the trucks OEM, we are a little bit careful. What we can see so far is some of our customers, they even locked the books in November last year. Instead, we opened the books only three, four months after because we cannot come up with the production. Now we see that some of the slots which were taken by huge customers lead are just postponed, shifted, whatever you call it in Europe, not in China at

all. In China there the run is real. In America is getting stable, and in Europe it is still positive. So that means for us, our assumption is still valid, we see a slight increase, we see positive market, we see a demand which is in our favour, but we don't see an exploding market and we don't see an imploding market. When I speak about this imploding and exploding 20% up or 20% down.

MZ [01:14:00] Right, thank you very much.

ML Okay.

O And now we have a follow up question from Sven Weier, UBS, please go ahead.

SW

Yes, thanks for taking my quick follow up question. The first one was really on the China Metro market because overall, I remember the past you said you were likely to lose some share there because the share was very high in the past. Now what we observe in the market is the Metro market is not so bad, but we see a shift from under to overground, and I was just wondering if that also relates to the market share situation, whether you have a stronger market share in the subways or if there's any difference in that. That's the first one. Thank you.

ML

As everybody points to me, I will try to do my best. In terms of the Metro market, I think whether this is underground or on the ground, [01:15:00] this is for us no difference. And by the way, to be very honest, I currently in this minute have no the information to split the Metro market between below and above. I don't have it. Eventually when you have it, and I can speak with Dr. Jürgen Wilder he sees a difference here. I assume very strongly that there is no difference. What we see is, and that is also something expectation management here to be very clear, our forecast so far for this segment of the market is very positive. We see an increase of roughly 20%, 25% to last year by knowing that last year was a horrible year, it was a very bad year for the overall market because in '19 we had roughly six and a half thousand, in 2020 we had nearly 8,000 Metros and they're coming [01:16:00] now with a number of 5,300 that's our assumption for this year.

What we see in the market is as more as this market is standardising, the more the Chinese standard is getting also in this segment, we have to fight. That means currently, the more differentiation we see from municipality to municipality, this is in our favour. this is our business concept also in Europe. The more differences we have, the better for us. The more it gets standardized, like in the high-speed train, the more it gets to the burden of the margins. Now you can say, but you are no longer really significant in the high-speed train. Number one, the high-speed train numbers absolutely they came down by 75% from the heights of 2015 to '16, and we are now currently in the market assumption of 80-100 trains, right? So this is really a fraction of what [01:17:00] it was. What for us is important is the after sales, what is important for us that we are coming still with components into this business, and what we are seeing and what we are working on is to be perceived as a Chinese supplier. The more we are perceived as a non-Chinese supplier, we will be taken out. This is the reason why we are very happy with our joint venture structures which we have there, and this is why we are considering that China itself, we have China for China, and this is a strategy which you not only hear from us, this is also what we have to do in

the near future and also in the Metros because if you are not doing it, we are facing significantly disadvantage in the play. And this is not only cost business regulations, this is tariffs, this is barriers which we are even perceiving so this is why we need to Chinese more our business in China to make it more [01:18:00] independent. And I give you one example. We have a lot of internal contribution that means we have a lot of supply from Europe to China with components, intercompany supply. We are facing in Europe, inflation, right? The Chinese translation currently is in the range of 2%. So that means price adjustments in China because of imported products is not negotiable so it's not easy to do that. So you could say even in our favour that the market for high-speed trains was so poor because one thing is for sure we could not just proceed what we did here in Europe and America just forwarding the inflation prices. We could not because they would say, listen, we don't have the inflation in China. So in fact, you could say the weakness of the market was for us an upside [01:19:00] because when we come back to a stronger market, then demand will high, supply will be eventually shorter, and then we can make the price adjustments, which we had to do anyway.

SW

Yeah, that's interesting insights, Marc I appreciate that. The second follow up was just really quickon the CVS order intake sequentially in Q1 the 130 million something increase, I was just wondering, was that entirely driven by the bounds in China? And also, on China you still sounded a bit more muted on the year which I would probably agree with because when we look at the recent monthly development, March or April was not so strong then so it seems to be indeed avery volatile recovery in the Chinese truck market. Is that also what you have served in the last couple of weeks?

FW

First of all, a bit spent in regard to the [01:20:00] first element of your question. The one reason why also the order intakes were higher than would you've basically had on as the consensus is driven to a large extent by what Marc said before. The closure of order books of some of the OEMs last year, reopening them in November, and then everybody joining in in order to secure certain slots within '23 for production and we don't expect those order intake levels to stay within 23 weeks we expect them to decline, again that goes of course, needless to say, hand in hand with our revenue expectation where we are also a bit more bearish like we discussed before. So we see it as well if you look at that the month, so similar few on things like you Sven.

SW Good, thank you Frank. **[01:20:58].**

O [01:21:00] The next question is a follow up from Calvin Chan Credit Suisse. Please go ahead with your question.

CC

Hi, thank you very much for taking my follow up. I just got one more question on your China JV/partnership strategy. So just as you plan to probably extend or further develop your JV or partnership in China to fight for China's strategy. Could you give us a bit more dynamics on the corporation with the China partner there and whether that will affect your kind of technology advantage

in your product over time? Also, in terms of the JV partner, I presume it's more local company, it's not your key competitor in China, like TYSJ, is that correct? Thank you.

FW

[01:22:00] Yep. Let me maybe first start, what you are potentially hinting at also with that question. We have been quite often discussing with you colleagues in regards to the joint venture strategy within China and whether a more connected, linked business set up with our partners could somehow solve the issues of reduced market shares that we have been facing over time and can avoid that going into the future. We have to say that the joint ventures are like we arecurrently set up, which are quite working extremely well. We are a very long lastingly respected partner for the Chinese give you one example as a Proofpoint CRRC has won [01:23:00] over the last year some roughly 20 projects in Europe where basically in 100% of those projects that they have won in Europe we are in as Knorr-Bremse with brake systems and doors, so they are relying on us. You can also say that clearly is potentially not intrinsically motivated that they want to have us in rather they would have their subsidiary supplying the brakes, but you see here the name, and the image, the perception that we have in the market, as the technology leader accounts in the Western world, and the end customer in the end defines them the relevant supplier at least for the safety elements of a train. Which is a good indication that the Joint ventures are running quite well. Second is to say, we can't, [01:24:00] of course strategically just go and call out for bigger Joint venture with CRRC without discussing on IP rights and how technology would be then steered globally for Knorr-Bremse, so this is of course a big issue for us because needless to say, Chinese partners would like to have a certain access to IP rights for the product which is of course a big hurdle for us to jump over. It's not so easily solved that issue. But our Joint ventures despite those potential bigger moves in China are running quite well still. Same as crew for truck division.

ML Got it, thank you. We allowed to ask them questions.

ML No. Credits and UBS we should not ask.

AS Okay. Then thank you very much for your time and for your questions. If you have further questions, please reach out to the IR team and we wish your great afternoon. Thank you very much.

FW Thank you colleagues.

ML Bye-bye.