Vitesco Q3 2023

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Vitesco Technologies Group AG
Conference Call Q3 2023

O **Operator**

HE **Heiko Eber**

AW **Andreas Wolf**

SN **Sabine Nitzsche**

MT **Marc-Rene Tonn**

O Good morning, ladies and gentlemen, and welcome to the Vitesco Technologies AG Conference Call Q3 2023. At this time, all participants have been placed on a listen-only mode. The floor will be open for questions following presentation. Let me now turn the floor over to your host, Heiko Eber.

HE Thank you very much, Operator. Ladies and gentlemen, I'm very happy to welcome you to our call on financial results of the third quarter, 2023. As always, the press release, the following presentation and our Q3 report has been published today at 7:00 AM CET on our Investor Relations website, in the reports and presentation section. You can also find the document with an overview of the most important KPIs on a quarterly basis available for your convenience. We will also make, as always, a recording of this webcast **[01:00]** available after the call. Now, before we look at today's agenda, I'm sure you have all taken notice of our by now, well-known disclaimer.

Today, Andreas Wolf, our CEO, and for the first time, Sabine Nitzsche, our CFO, since November 1st, 2023, have joined the meeting to guide you through our presentation on the financial results of the last quarter. As always, they will report on the most important developments at (01:33) and divisional level in the last quarter, including our current order intake level, as well as our cash flow and balance sheet. And finally, for sure, we will discuss our financial outlook for fiscal year 2023. Afterwards, both will be available for our Q&A opportunity. A necessary reminder. I would kindly ask you for your understanding that we will not disclose **[02:00]** further information on the Schaeffler tender offer at this moment, as we are awaiting the official offer from Schaeffler by tomorrow. For the Q&A session later, please be aware that we are conducting a Q3 call. Therefore, please limit yourself to the questions related to our business and financial figures. And now without further ado, let me hand over to our CEO. Andreas, please.

AW Yeah, thank you, Heiko. Ladies and gentlemen, welcome to our earnings call. Thank you for joining us today. The third quarter is in the books. It was dominated by two factors. We were able to achieve further improvements with regard to our profitability level as well as our cash flow generation. To give you some numbers, our adjusted EBIT stood at 3.5%, which translates to 76 million euro. Our free cash flow came in at **[03:00]** 73 million euro due to an increased profitability. Let me now continue with our top line development. Our sales decreased slightly to 2.2 billion euros in the third quarter. Apart from negative exchange rate effects, this was mainly driven by the accelerated decrease in our Non-Core sales, which is running according to our plans. At a very important note, our electrification progress continues. As you can see on the left hand side, our electrification sales increased to 324 million euros to be precise, this is a very good step up of about 30% compared to last year. An additional proof point showing our progress in e-mobility is our order intake. During the third quarter, we won about 1.5 billion euros of new orders in [04:00] electrification.

In total, we acquired about 2.5 billion euros' worth of new business. That means we have achieved an electrification order intake of almost 7 billion in the first nine months of 2023. Important to mention here, we have won orders in all major regions and across our entire electrification portfolio. This underlines once more, our attractive offering in that area. I can confidently say that we are well on track to achieve our order intake targets for this year achieving similar, maybe even higher electrification numbers as last year. Overall, to sum up, it was a positive, but also even full quarter. The focus of this call is on our Q3 financial performance, as Heiko already mentioned, but you will have seen that Schaeffler AG announced a [05:00] public tender offer for Vitesco Technologies Group AG for 91 euros per share on October 9th, 2023. Schaeffler AG is expected to publish the offer document tomorrow on November 15th, 2023.

As previously announced, our executive board and the independent special committee formed by the supervisory board will evaluate the offer document and merger plan by Schaeffler AG, taking into account the interests of all Vitesco Technologies stakeholders. The board will provide a recent statement of the offer including a recommendation to Vitesco Technologies shareholders, which will be published in due course. Let us now dive a little bit deeper into the financials. The 2.2 billion sales, which I mentioned earlier, correspond to a decrease of about 4% compared to the third quarter, 2022, [06:00] influenced by negative FX effects. The sales development is in line with our expectations, considering the plan phase out of Non-Core business, which decreased by 175 million euros in quarter three. Supported by strong results within our electrification and Core ICE business, we managed to increase our adjusted EBIT margin to 3.5%. Our CapEx increased to 6.4%. One aspect I would like to highlight in this regards, we are managing over 75 product launches in '23 and '24, which support our significant growth within electrification. Our free cash flow came in at 73 million euro driven by higher profitability. Even though we had higher CapEx, our strong operating cash flow resulted in [07:00] improved cash generation. And the final remark on our equity ratio with more than 40%, it remains at a very solid level.

Let's move on to the market view. The worldwide light vehicle production picked up during the third quarter '23. North America saw the strongest recovery followed by Europe. Still, I have to say that the Chinese commercial vehicle market unfortunately continues to be challenging. Overall, we saw an increase of 3.8% in light vehicle production. As you can see from the bar chart on the right hand side, in quarter three of 2023, our reported group level sales decreased by the already mentioned 4.4%. However, please keep in mind that our declining sales of Non-Core ICE business [08:00] and contract manufacturing, as well as negative FX effects are included in this figure. Organically, our electrification and Core ICE sales outgrew global light vehicle production by more than eight percentage points. As already mentioned a couple of times, this number is more meaningful when comparing ourselves to the overall market environment. And now you will receive more insights into our financial development from our CFO, Sabine Nitzsche. One personal note, I'm looking to my left. I'm very happy to have you Sabine on board giving us a fresh view from the outside with great experience from the semiconductor industry.

SN Yes, thank you, Andreas. Hello and a warm welcome also from my side, I would like to say a few personal words before we deep dive **[09:00]** into our figures. I'm very, very happy to be here at Vitesco Technologies. The team is super highly committed with a clear focus as defined and I have to say, a well-defined strategy and lots of passion. My dear focus is to help create the best future of our company. And of course, I put all my efforts to promote the success of Vitesco Technologies. So, and now let us take a closer look at our top and bottom line development at group level.

Even though you might see a smaller sales bar for the past quarter '23, our organic sales course was slightly above 1%. That excludes currency related (09:58) of 4.1 percentage points **[10:00]** as well as consolidation effects. Also, please keep in mind that the ramps down our Non-Core business by about 175 million euros in Q3 '23. Apart from exchange rate effects, this is the main reason for our declining sales approved level. As already explained by Andreas, we increased our profitability to 3.5%, which is even above the upper end of our full year guidance. And as the year is coming to an end, I can already say that our profitability for the full year is very likely to be the upper end of our guidance. One word on the status quo with regards **[11:00]** to negotiations of cost transfers apart from (11:05), we concluded the negotiations with all customers regarding cost transfer agreements on higher input costs. We did see positive effects in this quarter on both top and bottom line and the further experience positive impacts in Q4.

To sum it up, this result's very much in line with our full year target. And here I would say thank you, thank you to all our employees who really contributed every single day to achieve our ambitious targets. So now let's have a look at the resource of each division, and we are going to start with our powertrain solutions division. **[12:00]** The main reason for a slower growth was, as mentioned, the planned ramp-down of our Non-Core activity. Inside the segment, contract manufacturing sales alone was down by 40% year over year. Overall, Q3 sales came in at around 1.4 billion euros with an adjusted EBIT margin of 6.9% in powertrain solution division. Besides many factors, our continuous cost containment supported overall profitability levels in Q3. Another aspect I'd like to highlight, our Core ICE business continue to achieve double-digit adjusted EBIT margins. To put this into numbers, we achieved an adjusted EBIT margin of 12.5%. **[13:00]** And now let's move on to our electrification solutions division.

Here again, we saw the strongest growths underlining our ambitious midterm targets. We experienced a very strong top line development, which was especially driven by our performance in Asia and Germany. Our organic sales growth of roughly 22% equate to an outperformance of 18 percentage points compared to the global light vehicle production. And with regards to profitability, we managed to cut our losses by nearly half. As a result, we've further improved adjusted EBIT margin for Core ICE part of this division. This again demonstrates our efforts to turn this business back to **[14:00]** double-digit levels. You might remember this figure was negative in the first quarter due to material cost increases without full cost compensation. Quarter two landed at about 4%. Now in quarter three, we further improved our profitability in Core ICE to 5.7%. Let me now provide more transparency on the categories, electrification, Core ICE, and Non-Core. And let's start with the electrification part on the left hand side. As you can see, we further increased our electrification sales by about 30%.

As Andreas already mentioned, this was due to further ramp-ups of new products and the **[15:00]** better availability of critical components. And we will continue to grow. I would like to mention the approved adjusted EBIT margins by more than six percentage points, even though we had higher upfront costs for new product launches. Our second category, Core ICE, excluding electrification, experienced sales of about 1.3 billion euros. Here, negative exchange rate effects resulted in a flattish development year over year. However, we saw an increase in our adjusted EBIT margin by 0.9 percentage points driven by operating improvements in both divisions. As you can see on the right hand [16:00] side, our Non-Core business is further ramping down as planned. It also includes our contract manufacturing business. And you may have noticed the EBIT margin being slightly under 0%. But I would like to emphasize here, as we have already stated, our adjusted EBITDA Non-Core is a direct zero.

To summarize, first, within the electrification area, we will continue to grow significantly and further improve profitability towards the targeted breakeven in 2024. Second, already (16:50) Core ICE business will see gradual step-ups providing attractive EBIT margins. And third, [17:00] the ramp-down of Non-Core is progressing according to plan. Here, we will see further acceleration, especially in the area of contract manufacturing. Moving on to slide 11, I want to provide some insights on our cash development. As you can see, our operating cash flow came in much higher compared to last year. And to a large extent, this was driven by improved profitability. Our investment increased slightly resulting in investing cash flow of minus 130 million euros. As stated on this slide, it was mainly due to higher spending prior to project ramp-ups. [18:00] As a result, our free cash flow for the third quarter came in at 73 million euros. The strong development underlines our confident reach, our guided 50 million euros for the fiscal year '23.

Talking about our financing cash flow, it came in slightly positive. Main reason we had a minor bank overdraft in this quarter. This all resulted in a continuous comfortable cash situation, as you can see in our balance sheet. Having said that, let us take a look at our balance sheet structure. It has not changed much compared to previous quarters, which means we maintain a rock solid [19:00] and healthy structure. Our networking capital intensity decreased to 5.7% of sales in Q3 and is mainly driven by lower inventories and the accounts receivables. The networking capital intensity is therefore in line with our anticipated midterm range of 5 to 6% of sales. The net debt to adjusted EBITDA gradually remains stable and was at minus 0.3. Our net liquidity position of 270 million euros underlines our still very comfortable liquidity situation despite the (19:55) of our Non-Core business, especially contract manufacturing. [20:00] On top of that, we still have our existing RCF so that our available liquidity gross remains north of 1.7 billion euros, and our equity ratio remains at a very solid level of above 40%.

Now, I would like to move on to our expectations for the remainder of this year. Let me start with the left hand side and further elaborate on our guidance, which I guess is very familiar with you, as we have shown it already in our last presentations. Our outlook continues to foresee sales of 9.2 to 9.7 billion euros. However, given the ongoing weakness in the Chinese [21:00] commercial vehicle market, the continued decrease and lag in hybrid vehicles demand and expected negative impact, the currencies exchange rates will approximately come in slightly lower than the midpoint of our range. The adjusted EBIT margin is still forecasted at 2.9 to 3.4%. As such, we are progressing well with our transformation. We continue to stick to our strict cost containment and the further improvements in the supply chain. However, this effect will help us to trend towards the upper end of the guided marching guidance. Due to a high number of project launches in this year, we continue to expect our CapEx ratio [22:00] to range between 5 and 6% of sales for the entire year, fully focused on our core technologies and electrification.

Lastly, we still see free cash flow of around 50 million euros for the full year, as already mentioned earlier. Moving on to the market outlook on the right side, we saw changes in the regional development as the year progressed and the details per region, you can see in that box. In total, the changes amount to a new forecast for worldwide light vehicle production. We expect light vehicle production to grow by 6 to 8%, previously 3 to 5 on a full year basis. The increased expectations for global vehicle production in fiscal year '23 will be burdened, in particular [23:00] by negative currency effects and a slight decline in demand for electric vehicles, especially for plug-in hybrids. Furthermore, we are closely monitoring global political development, and given the uncertainty of these topics, we keep our guidance range unchanged. And with that, I have reached the end of my presentation. It was a great pleasure to guide you for the first time through the financial sections. And now I go back to you and ready for Q&A.

HE Thank you very much, Sabine. Thank you very much, Andreas. Ladies and gentlemen, as announced, we will now enter the Q&A session. And as always, we would like to offer all participants the opportunity to ask questions. So if time allows, you can of course ask [24:00] further questions by going back into the queue. Operator, we are now ready to take on the first question.

O Perfect. So ladies and gentlemen, if you'd like to ask a question, please press nine and the star key on your telephone keypad. In case you wish to cancel your question, press nine and star again. Please state now your question. And the first question comes from Marc-Rene Tonn, please state your question.

MT Good morning. I hope you can hear me. Thank you for taking my question, two, actually. The first one would be on the let's say sluggish demand on plug-in hybrids, which you have managed. Is it something which you regard as being, let say more reflection of a change in incentive schemes in certain markets, or more, let's say a structural issue, which may also, let's say have an effect on the years that may follow or let's say in the future? And the second question, and sorry for coming back a bit on the [25:00] Schaeffler offer. (25:02) give us some indication on, let's say the reception of this offer on the side of your clients. Do you already, let's say, have experienced any feedback from their side when it comes to let's say new order assignments, be it positive or negative versus let's say entirely neutral, and Vitesco is considered as Vitesco as it is today? Thank you.

AW Yeah. Hello. Good morning, Marc and Nitzsche. I would cover both questions, maybe starting with the plug-in hybrids, just to remember, we always said that 48-volt mild-hybrids also plug-in hybrids are a kind of bridge technology. We are focusing all our energy and developments, et cetera, on battery electric vehicles because we see the battery electric vehicles as the winners of the electrification. Therefore, for us, it's not really a surprise that plugins [26:00] are supported by incentives, et cetera. And there will be always bumpy developments over time depending on how the incentives look like. And therefore, we already knew that with the cuts in the incentives, the numbers will go down. It's now a little bit higher than we have foreseen. But all in all, not a big surprise for us. Coming to the second question, Schaeffler, so what are our customers saying? Not really a lot. So I'm in contact with all of them. Recently, there was no negative reaction. There was also not a... How can I say? Spontaneous, a positive reaction. I would describe it as neutral. So they just wait for how the new conglomerate, how the new company Schaeffler (new? 27:00) [27:00] by end of the next year will look like. And therefore, good starting point in the sense of not too positive, not too negative.

MT Thank you very much.

O Okay. So at the moment there seems to be no further questions. Please, if you'd like to state your question, press nine and the star key on your telephone and keypad. Okay. At the moment, no further questions. So let me hand back over to Heiko Eber for some closing remarks.

HE Thank you. So not a real surprise to see not too many questions given the current situation. Consequently, I would like to close today's call. Thanks for your time and as always, [28:00] feel free to reach out to our IR team in case of any additional questions. Take care and talk to you soon.