



# **Vitesco FY 2022**

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Vitesco FY 2022

Participants

Operator – Operator

Heiko Eber – Moderator

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Werner Volz – Speaker

Sanjay Bhagwani– Speaker

Christoph Laskawi – Speaker

Michael Jacks – Speaker

Marc-Rene Tonn – Speaker

Giulio Pescatore – Speaker

Philipp Koenig – Speaker

Edoardo Spina - Speaker

HE Ladies and gentlemen, I'm very happy to welcome you to our today's webcast on the financial results 2022. Our first year as an independent company after our listing back in September 21. The press release the following presentation and our annual report have been published today at 7:00 AM on our investor relations homepage. Furthermore, you will also find a quick summary of the most relevant KPIs on a quarterly and annual basis for your convenience and for sure we will also make the recording of today's webcast available to you afterwards. Now before we go to today's agenda, I'm sure that you have all taken notice of our well-known disclaimer. Today, Andreas Wolf, [01:00] our CEO and our CFO, Werner Volz, have joined the webcast to guide you through the most relevant information in our presentation today both on a group and on a business unit level. In addition of course, we will talk about our current order backlog, the relevant ESG KPIs and our cash flow and balance sheet. Finally, we will discuss the long expected outlook for our fiscal year 2023. Afterwards, both gentlemen will for sure be available for our Q&A session. But now without further redo let me hand over to our CEO, Andreas, please.

AW [02:00] Yeah, thank you Heiko and thank you ladies and gentlemen for joining today. I want to directly go into a slide which you are already familiar with as already mentioned. The fiscal year 2022 was the first one which was complete so that sometimes creates some problems comparing to 21, but we will go through that step by step. You see that in the headline challenging conditions, so 2022 was a year full of challenges and I cannot really call them two here. First topic I want to mention are the shortages normally linked to the semi-conductor industry key components for our products obviously, but also the Russia war against Ukraine imposed a lot of problems during the full year 2022. The other thing which I want to mention is the lockdowns in China linked to the Corona [03:00] situation which obviously also impacted our business. If I take

all that into account I still think that was a successful year for Vitesco Technologies. And in this slide here you are currently seeing we have a combination of some operational topics but also outlooks a little bit looking to the future of what can we expect from Vitesco Technologies looking to the odd intake et cetera, I will go through it now step by step. Now starting with a very operational number that's our sales close to 9.1 billion we already mentioned and you are familiar with the adjusted EBIT margin of 2.5% and number which is not shown here, the cash flow which 1, 2, 3 for the full year. That is showing that we moved into the right direction. Now looking to what I said before the transformational part [04:00] of the chart here. First of all our sales and electrification you'll see that on the left hand side, 1.1 billion and the 1.1 billion is an indicator for us that 2026 we want to achieve 5 billion, the 1 billion goes to five I'll come back to that. That's pretty much in line with our further outlook regarding sales. Now once again, on the right hand side you see the order intake for the electrification path so our product portfolio is really attractive. We achieved 10.4 billion for electrification only the full complete order intake being around 14 billion. The other thing which is always interesting is it's not only order intake but if I look to the progress we have on the adjusted EBIT margin for the electrification technology business units it's close to 10%. Now, [05:00] the middle part is very important and I will elaborate a little bit further in the next slide's on it. Our order backlog is around 60 million to be pre precise, 58.5 by end of '22. And the important number is 46% of that number of the 58.5 is linked to electrification. I want to go now a little bit more into that order intake. Now if you look to the spread, so what is in those 46%, and I want to translate it into an absolute number 46% means order backlog of 27 billion, what's in two third of that order backlog is linked to high voltage applications which is very important because you know that our midterm long-term outlook says that high voltage battery electric vehicles will be the mainstream in the [06:00] future. The order intake also implies and you can do your mathematics that the 5 billion we are targeting in '26 is sales for electrified components, is already 90% of that project that sales. So, we are good underway with our targets, you remember the 5 billion in '26 and the outer years we expected 10 to 12 billion around 2030. Now you see those typical KPIs also book to bill ratio for the business unit, electrification technology around 11.4, and if I take the whole company excluding contract manufacturing we are still around 1.7 which shows that the growth is already programmed in our books. Before I go to the next slide, I want to talk a little bit about what is to be expected in '23 [07:00] because we had in '22 evenly spread order intake always around two to 3 billion and due to the nature of the business I see it a little bit different in '23, so you cannot just take what we will publish then soon in quarter one and extrapolate, I see more ups and downs. But the most important information and key takeaway for '23, the number, so the target of the order intake will be the same like for 2022. To be precise we expect an order intake in electrification only around 10 billion but it'll not be so evenly spread over the quarter. So, more details will follow than with the next reportings. We already said back in October last year during our capital market day, that ESG, the performance we are showing in [08:00] that framework is very important for us because our products the long-term, the higher purpose of our company is linked to emission-free to clean mobility and therefore also the framework in which we are operating is extremely important and we have defined you can see that here on that slide six focus topics and I want to just mention a few examples how we perform. So just to mention again, the sales is good for 11.9, so close to 12% of our overall phase and you will see that step by step that percentage will increase significantly. You'll see the absolute number, I already mentioned for '23, the 10 to 12 billion, a little bit greyish on the right hand side. Climate neutrality, you see that on the right hand side is very important for us. So, the goal is that for 2040 we want to be climate neutral score 1,2,3, [09:00] that means 1,2,3, our own production but also everything in the whole supply chain. The step in between will be for one and two, our

own production and energy. We want to be climate neutral already in 2030 so where are we today at 92%, so, it looks very realistic that step by step we are completely going into the direction as mentioned of climate maturity scope 1, 2, and 3. The other topic I want to mention is as young company is being attractive for the talents of the world, so an attractive employer and what we are looking at is obviously having fair working conditions and the other topic is everything around diversity. The diversity topic I say is not yet our strongest points. So, in the next months and years we have to really focus on having more [10:00] diverse employee ship on board. More information will be spread and will be published beginning of April when the new sustainability report for '22 will be published. Now, looking into a little bit more the number side, as you may recall we guided in March last year with a little bit wider spread and then in line with quarter three figures, we narrowed that down. So you see that more narrow number set here on the left side, nine to 9.2 billion was the sales guidance we gave so we ended up around 9.1 billion. So, on the margin side we said we will be around 2.3 to 2.5, we ended up with 2.5, so more to the upper end. And you also see this nice [11:00] number of cash flow here a bit higher than what we expected, 123 million. So, let me go one step further comparing also to '21 because then we can see what does that mean compared to a full year '21. So first of all, if I look at the sales line you see an increase of 8.6% by the way will go more into the details after my short presentation here and if you look to the increased profitability of 50%, looking to the absolute numbers, that is really a big progress we made through our 2022, the 2.5% adjusted EBIT margin I already mentioned. Free cash flow 123, obviously supported by the goods EBIT we have demonstrated but also supported by VAT reimbursements. [12:00] Equity ratio above 40%. So, one thing which obviously played a bigger role was the re-evaluation of pensions and obviously also the positive year end result. And as always we will have now more financial details from Werner Volz.

WV Thank you Andrea. Hello and also welcome from my side ladies and gentlemen. Let us now take a closer look at the market on slide number nine. As Andreas already mentioned, many challenges led to a slower recovery of [13:00] the worldwide light vehicle production slower than the industry hoped for at the beginning of 2022. Europe was by far the weakest market in a very challenging environment especially due to the war in Ukraine. The North American markets as well as the rest of world in particular India and South Korea contributed the strongest growth. Also, the Chinese market had an impressive growth despite the pandemic related shutdowns at the beginning of the year. As we can see in the bar chart in 2022, our top line development was supported by currency effects. Our reported group sales increased by 8.6%, outperforming global light vehicle production by more than two [14:00] percentage points. However, organically and of course including the facing out of our contract manufacturing and non-core eyes technology business, we hope we were below the market growth at group level. Therefore, this does not really come as a surprise. The more important development is the organic sales performance of our core business where we managed to outgrow global light vehicle production by 2.5 percentage points. Let us now move on to the top and bottom line development at group level. Since we have already pre-released preliminary figures on February 23rd I will keep this session rather short and only focus on the most relevant [15:00] aspects. And please feel free to use the question and answer session if you want to ask for or discuss additional topics in further details. Due to the facing out of our non-core businesses including contract manufacturing, our organic sales growth was at 4%. That means, currency related tailwinds of 5.2 percentage points helped us to outperform the global legal market on reported sales at group level. As Andreas already mentioned, we managed to increase our profitability to 2.5%. That is around 50% in terms of absolute numbers compared to the prior year. [16:00] And around two thirds of our group sales are attributable to our core technology sales. Here, we show an improved the justice David

Martin of 3.7% excluding our business unit electrification technology which is still in a ramp up mode our adjusted EBIT margin came in at 5.7%. This is quite solid considering all the headwinds we had to face during the fiscal year 2022. Let's zoom now closer into electrification technology. The main sales driver for ET in 2022 was our strong growth in the Chinese and European market. The organic sales growth was at almost 18% in line with our expectations. [17:00] Despite being affected by the global supply chain disruptions, we also managed to increase our adjusted margin by around nine percentage points. With our order intake at €7.9 billion for ET only, we secured business from Chinese, Asian, North American and European customers. And with that, we will continue to grow in all our key regions. This also explains the burden on the adjusted EBITas this includes increased R&D expenses, and ramp up costs for new orders. Now shifting to electronic controls, both top and bottom line were significantly impacted by the supply situation already in 2021, [18:00] especially in the semiconductor area which began to ease slightly during 2022. Despite these headwinds, electronic controls was able to increase its sales and profitability, mainly driven by our recovering performance in core technologies which recorded for over 20% sales growth and the corresponding operational improvements. The most important regions here were South Korea and North America which contributed strongly to the good results. To sum up the key figures, the core of business unit electronic controls contributed €2.7 billion of sales at an adjusted EBIT margin of [19:00] 6.2% despite the cost increases. Now, let's move on to our business unit sensing and actuation. As in 2021, the headwinds from semiconductor shortage in sensing and actuation were lower than in electronic controls. Also in 2022 this situation didn't change and therefore we were able to compare to EC to support the increased demand from emission legislation in all major markets and to increase our organic sales by 3.3%. We also managed to increase our adjusted EBIT margin in further despite the negative operating income in non-core technologies. [20:00] The strong performance of our core technologies with 12.4% adjusted EBIT margin at 2.7 billion sales, helped us to significantly increase our profitability in sensing and actuation supported by our favourable product mix. Finally, let's look at contract manufacturing. There we continued our phase out process however, the overall market rebound amplified by the supply changes and the currency exchange related tailwinds stalled the phase out to some extent. Still sales decreased organically by nearly 7% versus 2021. [21:00] The adjusted EBIT came in at 1.3%. This decline was overall offset on group level due to goods we purchased from continents contract manufacturing under our bilateral relationship agreement, and in the next quarters, we will see further gradual decline in this regard. Overall, the group impact of contract manufacturing will remain neutral and the phase out continues according to plan. Now let me give you some more insights into our cash development. As you can see, we managed to increase the operating cash flow despite higher working capital intensity, and to a large extent this was driven by the [22:00] operational improvement as well as some extraordinary VAT reimbursements which we received throughout the year and some earlier than anticipated cash inflows from a couple of our customers in Q4. Our investments increased especially towards the end of the year resulting in an investing cash flow of minus €469 million. As stated on the slide, please keep in mind that last year's investing cash flow was supported by cash inflows from the disposal of assets in context with the spinoff, thus our free cash flow came in at €123 million. Despite the proceeds from the [23:00] issuance of the so called True Chain Darling of €200 million, the positive financing cash flow of €52 million was much lower than the previous years. While previous years financing cash flow included net proceeds from continental related to spinoff effects, this year financing cash flow was burdened by a settlement of derivatives related to intercompany financing. As a final point on our 2022 financials, let us take a quick look at the balance sheet structure. Our networking capital ratio increased to 5% in 2022 mainly driven by the increase in inventories and accounts receivables. The networking capital

intensity is beginning to trend [24:00] towards our anticipated midterm range of five to 6% of sales. The net debts to adjusted EBITDA ratio decreased slightly from minus 0.5 to minus 0.4. However, our net liquidity position of €333 million underlies our continuous comfortable liquidity situation. Considering undrawn credit lines our available liquidity at year-end 2022 was at €1.8 billion. The increase of our equity was mainly related to the positive full-year result as well as a higher OCI from pension revaluation. Consequently, this also contributed to an increase in our equity ratio of above 40% [25:00] at year-end 2022 now. As you can see, we continue to have a very solid balance sheet structure and cash position despite the mentioned challenges which we experienced in 2022. Before we enter now the guidance section of 2023, let me quickly summarise the past year whilst looking at the different quarters. We can see here how differently our earnings have developed over each of our four quarters, especially semiconductor shortages, the China lockdowns and the war in Ukraine led to a difficult start in 2022. On top of these challenges we suffered from higher cross input costs such as material energy and freight prices. We were able to end the year [26:00] with our fourth quarter on a stronger basis, especially due to higher and finally negotiated compensation payments which we received from our customers. All the mentioned effects are still valid for 2023 and will continue to impact the development of our quarterly figures as well in 2023. Especially the higher input costs along the complete supply chain are under negotiation with our customers right now and will not be completed most likely within the first quarter. To sum up, all these amplified effects will give us strong headwinds in particular in the first quarter. Now, we have kept you waiting long enough therefore, on our final slide letters come to our guidance for fiscal year 2023. [27:00] We have all hoped for a more normal 2023 after three years of huge challenges unfortunately, as I said, we are still facing significant headwinds due to cost inflation and continued market uncertainties and as said, the start into the new year has not been easy given all the additional burdens we have to deal with. In 2022 especially passing on our additional costs will have positive effect on the top line development but they'll also be margin dilutive. And yes, even though we expect the situation to ease gradually throughout 2023, we are cautious regarding the speed of recovery and the timelines behind negotiations and compensation payments. Now, let's look at our guidance for [28:00] 2023. Our outlook for Cs sales of 9.2 to €9.7 billion. This not only includes price increases due to higher input costs but also counter impacts due to the plant phase out of non-core ICE technologies and contract manufacturing. The adjusted EBIT margin will presumably amount to 2.9 to 3.4%, thus demonstrating that we are progressing with our transformation also in a challenging market environment and despite the margin dilutive effect we have mentioned before. The expected sales and EBIT margin figures however, require that we will be able to pass on an even higher additional cost increase in our prices compared to 2022. So far, negotiations with our customers [29:00] are positively ongoing however, not completed yet. That means we expect only limited effect from price increases in our Q1 figures. As these discussions will continue over the next few weeks most likely, we expect our CapEX ratio to be between five to 6% for the entire fiscal year, fully focused on our core technologies and electrification. When we look at our anticipated cash flow development for the current fiscal year, please keep in mind that we have favourable payment terms in contract manufacturing and with the planned bilateral phase out of contract manufacturing, we will see a corresponding negative effect in our working capital figures, thus our free cash flow target of around €50 million is below the prior [30:00] year level. Again, underlining upcoming challenges we have mentioned earlier but also underlining we are well prepared to tackle those also in 2023. And with that, I have reached the end of my part of the presentation Andreas and I are now ready for your questions, but first back to you Heiko.

- HE Thank you very much Andreas. Thank you very much Werner. Ladies and gentlemen, as announced we will now enter the Q&A session for our today's webcast. Since we [31:00] would like to give everybody the opportunity to ask the questions, please limit yourself to two questions at a time. And for sure if time allows we are happy if you would go back into the Q to place additional questions. Operator, we would be ready to take the first question.
- O Yes, thank you very much. Ladies and gentlemen, if you would like to ask a question please press nine, star on your telephone keypad. We would like to withdraw your question, press nine, star again. And we already have couple of questions that came in earlier. The first questionnaire is Mr. Sanjay Bhagwani of Citibank please go ahead sir.
- SB Hi, thank you very much for taking my question. So, I've got a few questions and also clarification to some of the points you alluded to already. So, the first one [32:00] is gentleman that you mentioned that on the electrification, the loan track 45 billion targets. When we talk about 23 electrification sales growth, I think prior message was somewhere around 400 million of extra sales given you have some of the new projects with Hyundai and also some other premium OEMs. So, that tells me a growth of somewhere around 35 to 40% on electrification top line, is that still the case for you? On the top of that let's say because some of your customers are actually doing well about budgeted for example Hyundai, so would you see an upside from that and are you well equipped in terms of capacity to deliver them the extra e-drive trains for example? So that's my first question and I'll just follow up thereafter.
- HE Thank you Sanjay. So Andreas?
- AW Maybe I go directly to those [33:00] two sub-questions. Hello Sanjay. First of all, increase in electrification, so the mathematics you made is also what I would do so something around 400 million. An increase depending on how the market really develops and that goes directly into the second one yes, there is an upside but still the markets are so weak and so volatile that I would be hesitant to call it upside already but we are equipped to also take this upside or translate this upside into additional sales, still depending on the product because we have seen that with some products we are linked to this again semi-shortage but all in all I look positively into '23.
- HE Thank you Andreas.
- SB Yeah, thank you. That's very helpful actually. So I'll just plug my other [34:00] questions into one. So, maybe talking about the gross margins of this electrification, I guess you're doing somewhere around two to 3% in '22, so how do you see this going in '23? I totally understand that the R&D is still strong and in fact that is translating into the order of intakes, but what improvement are you seeing on the gross margins on electrification? And then probably a bit unrelated to that but related to order intake I think you confirmed that you still expect somewhere around 10 billion of order intake in '23. But let's say based on the visibility you have now for Q1 and for the next few months, what run rate you are seeing if you can provide some colour on the order intake on electrification particularly?
- HE Yeah, understood. Thank you. Andreas, you would like to continue right away?
- AW Yes, I continue with those two questions. I would start with the second part [35:00] of the question the order intake. So first of all, just to frame it again because maybe the overall

boundary conditions are not so clear. If I compare '23 with '22, '23 is even I don't know whether the wording is okay hotter market wise than '22. So the chances for us obviously also for others are higher than what we have seen even in '22. Therefore I'm extremely confident that the order intake around 10 billion will happen. The only thing I mentioned and that was not negatively meant but was, can I say, a given effect that compared to '22 we will not always show something between two and 3 billion that gives them somehow the total of tenants. Depends on some bigger platforms which are in the pipeline we are very close to them which might lead to a [36:00] peak and then there will be a slower quarter and then there might be peaks again. But overall the 10 billion is really feasible, it even goes to the fact that we have to consciously select which ones we are going for, which is obviously also positive looking to not only the sales growth but also the increase in profitability. So, the quarter one is not over you have asked what is the run rate? By the way there is no run rate that's what I meant with those ups and downs during the quarter by quarter performance looking to the order intake. If I would have to guess for quarter one I would guess it's around 2 billion in electrification only, so not too bad looking to the starting of the year and the fact that the market is more heading towards quarter two, quarter three, looking to the order intake. So 2 billion would be my [37:00] best guess for quarter one. Now looking to the first part of the question, Sanjay, gross margin and electrification, you know that we came from very negative numbers and then we are targeting by the way, the same range of profitability if I talk just at EBIT margin in the outer years five to 7% and then even improving further. So, looking to the gross margin improvement I would expect a high single digit improvement looking to the gross margin in 2023.

SB Thank you, that's very helpful. So, just going back on the order side if I understood it correctly, Q1 is somewhere around 2 billion but then you are saying that it can be much more now in the coming months and then it can slow down and it can go back again, is that correct?

AW Yeah, exactly, I'm very speedy here cutting into [38:00] your words, sorry for that. That's a little bit because the opportunities are so high and the number of targets acquisitions we have is so high that I see really that it might happen that some orders come in a bundle, so that quarter two might be very high and then slowing down a little bit, slowing down means maybe only one or 2 billion and then the next quarter can be higher again. But all in all, again just to repeat a 10 billion is a very feasible number for the Vitesco Technologies.

HE Thank you Andreas. Thank you Sanjay.

O We have received quite a few questions. The next questionnaire is Mr. Christoph Laskawi of Deutsche Bank. Please go ahead.

CL Good afternoon. Thank you for taking my questions as well. The first one coming back to the order intake, [39:00] you just provided a lot of commentary which is much appreciated and indeed I read your comments that by end of age one you are comfortably ahead of your minimum order intake that you need to reach the midterm targets. So, could we read your confidence in also the full year order intake target that you scope to move higher than the 5 billion in the midterm? And then you highlighted that you by now can actually more or less choose which orders to take on also considering your capacity that it makes sense to choose, what are the hurdle rates and where do you plan to grow most is there a specific regional approach that you choose to go about it or is it just the margin and strategic partnerships? That will be the first block of the question. And then earlier we saw headlines on the ticketer that the



Q1 margin might not [40:00] see the level of Q1 last year, just walk us through the building box of the bridge versus Q1 '22 and why the margin should be lower after fairly decent margin in Q4? Thank you.

AW Thank you very much Christoph.

HE So, maybe we can split it so that Andreas takes the first part of the question and then Werner elaborate a little bit on Q1.

AW So first of all let's talk about order intake. I mentioned that I would guess quarter one being around 2 billion then it depends on what happens in quarter two. A lot of very interesting projects are in the pipeline, so it could be that we are compared to a linear curve in end of age one above those lines, that's very realistic to take this into consideration. Does that mean that we are improving the number of 5 billion? First of all I want to [41:00] just mention again the 5 billion is secured because I mentioned that number 90% of those orders are already in our books so everything which now comes on top is securing. I would say the years after because the 5 billion is '26 now we are in '23. The typical development time and all industrialization is around three years for this very complex product it might hit 26. So to basically go from 90 to 100%, but the full volume will be then in the outer years. We have to pick and choose the market gives really the potential to move into the right direction. I don't see that as explained the 5 billion will be significantly higher because basically all the audit intake coming now will with a full swing hit the outer years. Now [42:00] for the margin site and partnerships and so on. I mean we gave that outlook where do we want to be with electrification step by step that we are in the range of five to 7% our break even. I don't have any data telling me today that we will not be able to be in that range we already published.

HE Thank you Andreas. So on the Q1 profitability banner, maybe without taking all the powder for our Q1 number since Christoph as you remember, Q1 is still ongoing.

WV Yes. I try to elaborate on the logic of this chart which I already have had put into my presentation where we have outlined the development of the four different quarters last year and you Christoph you referred to the very [43:00] reasonable margin in Q4. Again, this was not the pure operational effect of Q4 only, this included catch up effect from the previous quarters they had been below obviously the average of the overall year and then I have to refer to the input cost increase that we suffered last year. We always explained that we expect that to be in a mid-size triple digit million euro amount. So, take 500 million of input cost increase last year and a large extent we were able to recover from our customers. We recovered that to a certain extent by price [44:00] increases, we recovered that by one time payments, we recovered that by other contributions from our customers. Meaning that we don't see for all our products a continuous price line coming from 2022 now going into 2023 covering the cost increases from last year. On top of that this year 2023, we will see additional cost increases probably similar size on top of it what we have experienced last year. And this is what we are going to negotiate and this is obviously something that we haven't realised yet in the first quarter this is ongoing. However, I think in Andreas is heavily involved in these negotiations while we get good indications that we also again should be able to negotiate these burdens [45:00] also for 2023 as we achieved it for 2022, which was by the way a paradigm change in the market at least for us looking back. And this is a similar game that we're playing and starting now in 2023. Did that answer that question Christoph?

- CL It did. Thank you. Just to follow up on how you select the orders that you take on I was actually referring to you can probably be a bit more picky and go for orders even above the target range, but no, I take your point that you are well on track to reach the target. That's clear. Thank you.
- WV Thank you Christoph.
- O Next we have Mr. Michael Jacks, Bank of America, your line is open.
- MJ Hi, good afternoon Andreas, Werner. Thank for taking my questions on the first one, perhaps if we could just go back on the cost side for this [46:00] year. You just mentioned in the previous question that you expect cost inflation to be similar in magnitude to last year at around 500 million. Could you perhaps just walk us through some of the underlying assumptions for the different cost buckets with regards to energy, wages[raw marts? 46:17] and electronic components and if R&D contributes to that as well as a factor if you could just walk us through that? And then my second question is just on your light vehicle production assumption, it is a little bit ahead of S&P, I guess It does somewhat reflect the ambitions of the OEMs for this year, but has the run rate that you've seen in Q1 thus far reflected this or is this based more on the production schedules that you've received from your customers for later on in the year? Thank you.
- HE Thanks Michael. Werner, what do you like ...
- WV Yeah, I'll start with the first portion [47:00] and probably also go with the second part of it and well starting with the cost inflation we expect to see similar additional price increases on material costs compared to last year. Even though we see certain categories like copper and steel already on a backward strand but on semiconductors we don't see a release. So, that is one major additional burden for 2023, you were mentioning energy I think here in energy market and also our cost assumptions are going to relax a little bit more. So, we have seen the peak at the end of last year but we saw the decrease already in the first couple months this year. That is the least portion of this additional [48:00] cost increase. The other big portion of course is personal costs. So, labour really is increasing significantly well you probably have heard about the labour increases that we are going to suffer or that we are going to have to cover for in Germany around 5% we see at least similar size increases in other European countries, especially in the eastern European countries. We even see double digit increases, we had increases that size last year already in North America, not in as a full-blown average but so labour that is the next significant portion of [49:00] this, well you measured it with roughly 500 million. And these basically are the two levers.
- MJ Now understood.
- WV The LVP and the IHS for outlook while here we expect three to 5%. I think that is pretty much in line with S&P and we saw so far, rather slower first two months this year specifically coming from lower volume and in the slower markets in Asia specifically China in the first two months. But also this is I think not a real surprise that typically relates to the seasonality holidays in China. [50:00] Right now we see indications that this is going up now.

- MJ Yeah. Thank you. Maybe if I can just add one quick follow up just on the compensation or pricing recovery. I understand that negotiations haven't been fully concluded yet, but is it possible that we could see some more lumpy compensation as we saw in Q4 a little bit earlier in 2023, perhaps in Q2 or Q3? Or do you think it's also going to be back ended more towards Q4?
- AW Maybe I take that part because as Werner mentioned, I'm involved in many of those negotiations and discussions. Yes, it will be different to 2022 because as said, 2022, we were somehow all surprised and that we started our negotiations and it was back ended in the sense of quarter four and we saw that in the numbers we got some of those compensations for the full year 2022. So, the goal in '23 is, [51:00] and I said I'm quite optimistic is to translate all those cost increases into price increases and not in one time payments but assuming that those negotiations will end in the next couple of weeks or maybe a month or two there will be one portion which goes then into starting January 1st to see how that can be compensated with the down payment and the rest will be done by price changes but not back ended as you said into quarter four. I see that more in the next quarter maybe the quarter afterwards, but not quarter four.
- MJ Yeah. Thank you very much.
- HE Thanks Michael.
- O Next we have Mr. Marc-Rene Tonn of Warburg Research. Your line is open.
- MT Yes, good afternoon and thank you for taking my questions, two basically. First one would be and you said a lot on other intake already, but that's [52:00] longer term and looking beyond 2023, I think they had recently been some discussions again on potential insourcing outsourcing trends I think you provided the terms on good indication on your capital market day when you outlined what you would expect in terms of insourcing outsourcing. So, my question would be do you still stand with what you have said last year or are there any changes to the positive or negative side on this outsourcing? The second question would be on the margin, particularly with regard to the core business and sensing and activation I think the fourth quarter was a bit weaker than in this three previous quarter. Now let's say considering the compensation payments which you let's say experienced more in Q4 compared to could kill some medication which was behind this let's say a bit perhaps softer profitability in this segment in the first quarter. Thank you.
- HE Thanks Marc. So, I really appreciate that you always ask questions that I can assign on the one hand to Andreas and second part to Werner. [53:00] So, let's keep this pattern.
- AW Marc, I want to be a relatively short with my answer. No major change in our assumptions compared to the CMD back in October. There are some trends showing us that it goes more to the supply side to the supplier again, others talk openly about doing things by their own and don't forget that we have to be precise what is really meant. So there's one portion where we say the full product comes from us. That was in the one statistics we have shown when we look to the volume increase of the products and there is then, which we have to adjust a little bit in our charts, there is a portion where our customers say we want to do the final assembly. So, we are still delivering the components of that product, a state, a rotor or a power module for the inverter. And then there is a rest and that [54:00] rest is relatively small where customers say, I want to do everything by my own. I produce the PCB, I produce power modules and so on that's the smallest part of the equation. So, again, all in all no major change.

HE Thank you Andrea. Okay, Martin on core business as in there, well observed Marc and quick answer and short answer is that overall I was mentioning the fact that our core business due to the positive product mix overall was improving the overall profitability there in sensing an actuation. However, that product mix was weaker in the fourth quarter specifically coming from the lower Chinese market and here again related to some of our commercial legal business which was [55:00] burdened in the last quarter in sensing an actuation.

MT So, nothing sustainable just an issue for the fourth quarter and it should normalise in the course of this year.

AW Yeah.

MT Thank you very much.

AW Thanks Marc.

We still have some questionnaires left. The next questionnaire is Mr. Giulio Pescatore from BNP Exane. Please go ahead sir.

GP Hi, good afternoon. Thanks for taking my question, the first one I want to go back on inflation just briefly. You have a range in your guidance is it fair to assume that the range also includes different assumptions on inflation or that's mainly linked to the market? And if we take the midpoint of your range, what type of coverage of costs are you assuming? What percentage of cost do you think to be able to offset with pricing? Then the second question on the other book, so far the focus has been on the size of the other book, but of course when you take a business from [56:00] 1 billion of sales to 10-12 billion of sales potentially in 2030, there are some execution risk that we need to be mindful of. What are the key concerns in your mind and is it going to be smooth sailing or there are some actions that you need to take to make sure you can heat that target in a profitable manner? Then just one couple a brief points on maybe a bit more important for Mr. Werner your capitalization ratio increased. So in 2022, what should we expect going forward? Is this a one off effect or should we expect the capitalization ratio to be sustainably higher? And then just on interest, cost and income given that the VAT benefits can you just help us model this cost in 2023. Thank you.

HE Thank you Giulio. So, maybe we turn it around and start this time with Werner. Maybe the first and the last part of Giulio's question.

WV Well, the [57:00] range mainly is related to the huge amount that we have to negotiate and pass on in additional price increases coming from our increased input cost. So, that basically is the major driver for the range and what level of pass on we would need in order to reach ship. Yeah, so well last year we were talking about at least recovery of 80%. We got to that probably we got close to 90% last year on that regard and this is also similar size that we' at least need to thrive for this year. So, I think we were talking about the overall size that we have to apply for 2023 and between 80 and 90% we also would need to [58:00] recover and that is what we are at least going for right now and that is reflected in these ranges. So the next topic that relates to R&D capitalization, yes, that is an increase of I think it's around 25 million compared to the previous year and it reflects the capitalization rate of around 11%. So, compared to our industry standard

that is rather low. And reflects the new products that we are currently right now developing related to electrification technology. While our philosophy and politics is to keep that capitalization rather capped on the other side we cannot avoid IFRS procedures and rules and need to capitalise in order to meet IFRS requirements. [59:00] So, we probably might see a slight increase in absolute terms since we increase also our efforts there in electrification. But in terms of relative terms, I think we should see similar ranges also moving forward. I think that was it.

AW Maybe I continue with the order book part of your questions, Giulio. I think it was Christoph already saying during the summary of we can be a bit more picky looking to the orders we are taking in. I would use a different term also to answer your question, key concern execution. How stressful are those new orders for us, and how do we measure this whether our orders are stressful or not. We have some KPIs. [01:00:00] KPIs could be that an order means only, don't take me wrong, a capacity increase so no development needed. That's something where we would say we go for it because we have already developed a product and now the customer says I need more or in additional regions so that's easier to execute than developing a new product. That would be the second by the way, how close is that product the customer needs to our platforms? So the closer the product to the platforms, the easier it is also with lower manpower to develop this product and industrialise it. And that's how we look to it because we are really looking in detail on executive board level and one level below that we want to make sure those orders we have already in our order book, but which we are then in addition [01:01:00] getting in '23 that we seamlessly develop industrialise them. We know that we would spoil our name, we would spoil let's say how the industry looks to our track record and we want to avoid that we have too many orders at the end and are not able to really execute them. Therefore this consciously looking into for which product, for which orders do we go. I hope that it was a bit longer as explanation, but very important that we execute as wished by our customers.

GP Thank you.

WV Thank you Giulio.

O We still have a couple of questioners left. Nevertheless, I will repeat the combination to raise a question. It's nine followed by a star on your telephone keypad. And [01:02:00] next up we have Mr. Philipp Koenig of Goldman Sachs. Please go ahead.

PK Yeah. Hey guys, thank you also for taking my questions. I just have a follow up on your new reporting structure. You're obviously planning for break-even margin for electrification business next year. So, going from somewhere around 300 million of losses to around to break even next year, what can we think about this year if we're trying to bridge it and what are the moving drivers there? Then if we think about the other part of the business, the powertrain solutions, what should we think about the margin there? Do you still think that margin there will expand with the recovery LVP or do you rather see a stagnation if you're trying to square that with your group guidance for this year? Thank you.

WV Well maybe I can take that. So, the major improvement also in our [01:03:00] guidance and outlook for 2023, it's coming from electrification technology, which we expect to further improve with further scale effects but also operational improvements in a similar size that we have seen that in 2022. So that is basically the major improvement in profitability while with the rest of powertrain businesses we're expecting to be at least at the level of 2022 considering the fact of

the cost increase and the input cost increases and the ongoing negotiations I think that is the rough summary. Is that answering Philipp?

PK Yeah, so basically the improvement in the underlying earnings is coming from the electrification business basically free trying to?

WV Exactly. Yes.

PK [01:04:00] Okay.

WV Break even still stays with 2024 so that is still confirmed our plan and right now no indication that we would move away from that.

PK Great, that's great to you. Thank you very much.

HE Maybe just as a general reminder, I mean we will for first time report in our new structure with the Q1 numbers and of course as we have promised during our capital markets say last year, we will make sure that there is a for comparison so that you not just see new numbers and you are not able to compare them to our previous performance.

O Thank you. Next I have Mr. Edoardo Spina of HSBC. Please go ahead.

ES Hello, thanks for taking my two questions. The first is on the working capital, the impact of contract manufacturing. If you can repeat the reminder so much [01:05:00] there is a negative in 2023 and also for 2024, I don't know which year you expect this to go away. The second question, just to clarify and confirm what you said earlier I understood that you are definitely more optimistic about the negotiation for pressing with OEMs in 2023 compared to last year. However, we should not expect any impact on the first quarter yet because you have not closed the negotiations.

HE Yeah. So okay, maybe we keep the sequence type with Werner on the working capital and then Andreas on the negotiation.

WV Yes. Edoardo working capital and I just try to explain the logic so in working capital or in our contract manufacturing terms with continental, we have favourable payment terms on our side related to goods [01:06:00] received from continental slide. Now with expecting decreasing contract manufacturing both sides and that is similar size is on both sides again, so that is pretty much parallel. So, what we reduce as sales on our side it's not synchronised by purpose but by nature it's happening pretty much similar on the other side. So, we're losing the positive payment effects that we have right now by gradually decreasing goods received from contract manufacturing from continent tile site. And since we expect contract manufacturing to significantly decrease over the next two years, so that means in 2023 and 2024, we have indicated what we expect [01:07:00] with those two years we phase out contract manufacturing already to a large extent. So, that obviously then also is the time where these negative effects hit our working capital and it is basically the size of contract manufacturing related to the payment terms. After that we will see the overall situation normalised again, but the next few two years we will see negative impacts coming from that effect. I'll just quickly on the first quarter I think it's

not that we don't see any effect, but obviously not the total amount and Andreas, maybe you can elaborate.

AW I want to elaborate a little bit on that so we [01:08:00] don't say that there is no progress and all will be back ended. We already have concluded on a couple of customers and we see that odds in our books in Q1 but not in a linear way. So there's still the larger part where we have to close the negotiation. So we see some positive impact already in quarter one, but the larger one will be then basically in the next quarter including catch up effects and we will have those catch up effects then for quarter one as you said, because we are negotiating for the full year, January 1st, December 31 and everything which was not concluded until now will have a compensation effect then for the first couple of months. So let's assume we would have a customer and we would sign and say that's it in April there would be then April forward it would be basically [01:09:00] put into the prices so it would be compensated via price, but for the first three months we would then get a compensation which would fall. That's the logic in the financial system which would fall then as a one-time into quarter two.

ES Thank you very much sir for your answer. Sorry about the working capital, you expect 250 million reduction in phase. I think on contract manufacturing is the same amount you expect as a working capital headwind?

AW I think the size is fair to assume. I think it also could be around 300 million and I'm not sure if I understood it right. What do you mean with headwind?

HE What cash effect comes out of this reduction?

AW Well it's roughly two thirds coming out as negative cash effect out of that.

ES Okay. Turn on to 100. Thank you very much.

IH [01:10:00] Thank you.

O At the moment there are no further questions, this is the last call. For any questions left ladies and gentlemen if you still have a question this stage please press nine, star. There seem to be no further questions in the queue.

HE Thank you. So, since there are no further questions, I would like to close today's call but not before I would like to express my thanks to you guys for the very active participation. Also thank you to our today's speakers and of course a big thank you to all the guys in the background making our event possible. So, with this I wish you a pleasant rest of the day and as always, if there are still question open don't hesitate to give us a call. Thank you very much for your time.