Transcription

TRATON SE – Q1 2020 Conference Call

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PRESENTATION

00:02 Operator

Dear ladies and gentlemen, welcome to the Q1 2020 call of TRATON SE. At our customer's request, this conference will be recorded. As a reminder, all participants will be in a listen-only mode and, after the presentation, there will be an opportunity to ask questions. If you would like to ask a question after the presentation, please press 01 on your telephone keypad. If any participant has difficulties hearing the conference, please press * followed by 0 on your telephone for operator assistance. May I now hand you over Rolf Woller, Head of Treasury and Investor Relations, who will lead you through this conference? Please go ahead, Sir.

00:34 - Rolf Woller

Thank you very much. A very warm welcome here from our side and from the Munich office. We hope that everybody who is dialing in is in good health, and also that your families are well. Together with me in Munich, sitting in almost three different offices, are several members of the core team: of course, our CEO, Andreas Renschler, our CFO, Christian Schulz. And then we have Klaus Schartel, Head of Law department, Annette Danielski, Head of Finance, Julia Kroeber-Riel, Head of Corporate Communications, and myself.

Before we start to give you an update on TRATON during the first three months of 2020, I have to make some initial remarks. We hope you have all seen the materials we published in the course of this morning – it should be the press release, the quarterly note, as well as the IR presentation. If you have not received them, you will find them on the TRATON IR website. I should make you aware of the disclaimer, which is on page 2. And I also wanted to state the obvious right up front: if you have any questions on Navistar, you know the proposal is out since January 30th, and there is no change in status. Therefore, we currently have nothing to add to what has been announced so far. How will we proceed today?

First, we have Andreas, who will give us an overview of the current situation, and once he is finished, he will hand over to Christian, who will guide you through the financials during the first quarter and our status outlook. And, last but not least, we will close the session with a Q&A session. I would like to remind you to please limit yourselves to 2–3 questions per person, otherwise it will be a very cumbersome and boring approach here. With that, I hand over to Andreas. Please, Andreas. The floor is yours.

02:59 - Andreas Renschler

Thank you, Rolf. Also, a welcome to all of you. Before Christian elaborates on the financials for the first quarter, let me make some introductory remarks on the current situation. With the COVID-19 pandemic, the global economy is faced with an unprecedented situation, even not comparable with the global financial crisis more than ten years ago. Caused by the pandemic, we have seen and continue to see falling demand, supply chain interruptions, temporarily closed factories, and customers focusing on securing their liquidity. Driven by the standstill of nearly all industries around the globe, the economic outlook for 2020 has been clearly reduced, in some countries, to levels not seen since the Great Depression. This has accelerated a downtrend in the commercial vehicle market globally. Even so, expectations before the pandemic had already been low, in particular for the US and Europe. Furthermore, as global supply chains are not restarted, with unpredictable frameworks and many unknowns, the bandwidth of the listed forecast illustrates the high uncertainty for the weeks and months to come. Even the American Commercial Transportation Research Institute, a leading publisher of commercial vehicle industry data for the North American market, recognized – let me read it – that "there are too many unknowns to form an expectation with confidence."

This, of course, has affected and is still affecting us across the board, but we have implemented effective counter-measures. First, we ensured that we protect the health of all our employees across the globe. Suspension of production was in line with the availability of parts, given the impact of the corona pandemic, government requirements, the development of the market and resulting modes of operation of the plants. Administration employees started working from home, wherever possible. We introduced unemployment assistance to strengthen our financial position during the production stop, and further focused on safeguarding liquidity through several actions. Just to shed some more light into that, we introduced short-term work – the so-called "*Kurzarbeit*" – for the majority of our employees at MAN, and where possible, in group functions based in Germany. Further, in Sweden we put roughly 19,000 people into kind of a similar unemployment assistance program, and in Brazil we entered into so-called forced vacation.

As the transportation industry is systemically important and system-critical, we continued our service and replacement parts operations, with more than 10,000 employees supporting the daily needs of our customers. Important innovation projects are being continued. We also supported society and joined the effort to overcome the corona crisis with targeted relief campaigns. TRATON, for instance, supports the "DocStop für Europäer e.V." association for European truck drivers, which provides for an improvement in medical care and working conditions for bus and truck drivers on the road. Meanwhile, we prepared our production for a gradual safe restock by coordinating the reliable supply of parts, by our suppliers as well as the organizations of our own work processes, by protecting our colleagues, but also initiating measures to stimulate demand for commercial vehicles.

Scania has initially tested the stability of its supply chain and its production line processes in Sweden and the Netherlands successfully, and further continue to ramp up their operations in France and Brazil. MAN Truck & Bus has restarted its bus and truck production step by step, and will continue to do so in the weeks to come. Same is valid for Volkswagen Truck & Bus in Brazil, who started the assembly line of its main plant in Resende back into operation on April 27th. The plant of Volkswagen Truck & Bus in Mexico is scheduled to re-open today. Lastly, we are re-starting administration functions depending on COVID-19 development and regulations in the respective countries.

Clearly, for our company, a sound balance sheet and the necessary liquidity are the names of the game in this crisis, at the moment. In general, our balance sheet position is strong, with an equity ratio within the Industrial Business of higher than 37% and net debt/adjusted EBITDA ratio of only 0.1 times. At the end of the DPLTA between Volkswagen AG and TRATON SE, terminated as of December 31st 2019, EUR 1.4 billion were transferred in February 2020.

That also holds true looking at our liquidity. We have initiated additional measures in the current environment in order to monitor liquidity even more closely, identify bottlenecks at an early stage, and make additional liquidity reserves available to us. With unrestricted cash of more than EUR 2 billion and credit lines of more than EUR 5.5 billion, we are able to safeguard liquidity in these uncertain times. By implementing strict cost management across the group, further reducing operational cost within our plants, and re-prioritizing investments and R&D, we took decisive action.

As I highlighted before, we have already implemented our gradual re-start. Clearly, we at TRATON are well prepared to get back to old output levels, but it is obvious that the pace to get there is determined by a combination of factors. Supply, as well as demand disruptions can interfere our gradual ramp-up and force us to prolong or adjust the ramp-up steps from today's perspective. Similarly, the influence of economic policies and overall health and safety measures will decide how fast we can proceed to fully establish our operations. Simplified, there are three scenarios on how the economy can develop. First, the most desirable option is the V-shape scenario, where we return to the pre-shock level at the same growth rate. That would mean a fast recovery as a catch-up effect. Second, the U-shape: here we could expect growth at lower levels than before, but at the same growth rate, leading to a delayed recovery. Last, and most undesirable, is the so-called L-shape scenario. This scenario would mean entering a period of growth at a much lower level, in combination with a lower growth rate, which can be then summarize as no recovery or recession. Besides the mentioned three scenarios, of course, further manifestations are possible, like the W-shape scenario. Overall, the next weeks or months will show how the combination of the aforementioned factors will affect our business. At the time, it's not so clear. We do not have a crystal ball available to see how things will develop, but we are preparing ourselves for the different scenarios, testing out production. We still have a good order backlog that we can use now. And, depending on the order intake that we will see over the next couple of months, we will see how we can run further and increase production rate.

With that, I will hand over to Christian, who will give you more details on the financial figures.

12:12 - Christian Schulz

Thank you, Andreas. A warm welcome also from my side. Let me briefly summarize our first three months of 2020 from a CFO's perspective before we go back to the presentation. I think it's fair to see that we were running ahead of schedule in January and February of 2020, on both sales revenue and operating profit, despite an expected weak market environment for Europe. However, starting in mid-March, the decline of the European market accelerated and led to a disproportional decline in operating profit in the Industrial Business in Q1. The net cash flow in the Industrial Business, however, improved year over year, amounting to EUR -167 million and was therefore better by more than EUR 200 million compared with the first quarter of 2019, if you adjust for the sale of the Power Engineering business.

You know the rest of the story quite well. Due to the COVID-19 pandemic, we had to shut down all our plants gradually, starting from mid-March onwards. Since the environment continues to be characterized by substantial uncertainties regarding the duration and severity of the disruptions, the impact resulting from COVID-19 on customer demand, the supply chain, and production cannot be accurately forecasted at the moment. Therefore, an updated prognosis on our business development in 2020 is still not possible. However, with operations almost completely shut since late March, we managed to gradually restart our production operations at the end of April. With the continuation in May being a further month of the stepwise ramp-up in production, we expect a substantial drop in sales revenues in Q2 2020, which will affect all other key figures negatively.

So, what can we say? We started from the very beginning to have a close look at cash and liquidity. At the end of April, as Andreas has mentioned, we had more than EUR 2 billion of cash available and more than EUR 5.5 billion of credit lines. So, I think it's fair to say that this gives us some freedom to address the challenges ahead with determination. With that, let me return to the presentation and to page 8.

Unit sales were down by 20% to 45,990 units in Q1, but as you know and as we already discussed, we have seen a deceleration in the overall trend, which already started back in the second half of last year. The reduction in Q1 was mainly driven by the truck business, with markets down – as expected – in the EU27+3 region. The impact of COVID-19 in March further accelerated the decline and curbed the growth in Brazil and Argentina. Scania and MAN saw double-digit percentage declines, whereas volumes were stable at Volkswagen Caminhões e Ônibus compared to Q1 2019. TRATON Group's sales revenue decreased by -11% in Q1 and fell less than unit sales, mainly due to product mix. Sales revenue in the bus business showed an increase of +11%. The aftersales business posted a slight growth of 2%. The operating profit in the first quarter was down to EUR 161 million, but it is still positive. Operating leverage arising from the volume declines and increasingly difficult used vehicle businesses, together with higher depreciation and amortization charges, as well as costs in relation with the rollout of the new truck generation at MAN Truck & Bus, led to the margin decrease.

Looking at return on sales by brand, Scania return on sales was coming in at 8.6% , -240 bps compared to the first quarter of 2019, and Volkswagen Caminhões e Ônibus at 3.1%. Both were resilient in that environment. While the operating leverage was higher at MAN Truck & Bus, we expected MAN to be weak in Q1 2020 because of the dual production cost, as we have discussed, coinciding now with the decline in the European truck market. COVID-19 led to a deterioration of the situation in the second half of March and, because of this, the operating profit margin declined to -3.4%, a significant reduction compared to Q1 2019.

Profit after tax declined to EUR 96 million as a consequence of the low operating profit and less favorable financial results, and an increasing tax ratio of 27%. Last, as you can see, cash flow in the Industrial Business was EUR -167 million versus EUR 1.6 billion in the year before. As I said in my intro, please keep in mind that last year's investing cash flow was supported by the sale of Power Engineering with EUR 1.978 billion. Excluding this effect, the industrial cash flow year over year improved by more than EUR 200 million, despite the slump in operating profit.

Just a word about the Annual General Meeting: we decided to postpone the AGM for fiscal year 2019. It was previously scheduled for May 28th. Due to the strong spread of the coronavirus, we will now announce a new date in due course.

Let us have a look at the two segments. I am on page number 9 now. You can see that in the Industrial Business, the first two months of 2020 were on track, despite the expected weak European truck market. Key figures in March were then negatively affected by the COVID-19 pandemic. As you know, March is seasonally the strongest month in the first quarter.

Incoming orders softened and declined by -16% year over year in the first quarter. The incoming orders for trucks went down by 18% in Q1 2020. Looking at the incoming orders with the truck business, there was a considerable decrease in the European region, driven in particular by the economic downturn and the acceleration due to COVID-19 in March. A similar trend was visible in South America, especially in one of its main markets, Brazil. Incoming orders increased in the Middle East and the Asia–Pacific regions.

Incoming orders in the bus business were up. We have a strong increase in January and February, but a significant reduction in March based on the COVID-19 pandemic outbreak. The coach business came to an abrupt halt. Unit sales, as already mentioned, were down by -20% compared to the previous year. The book-to-bill ratio in the Industrial Business for Q1 was up to 1.2. The sales revenue in Q1 in the Industrial Business was down by -12, less than the unit sales decrease. The operating profit was down to EUR 135 million, and the return on sales stood at 2.4%. Return on sales was impacted by the decline in sales revenue, additional cost due to the rollout in the new truck generation in MAN Truck & Bus, and an increasingly difficult used vehicle business. In addition, measures taken in connection with COVID-19, in particular the closing of all our plants, had a negative impact on sales revenue. We already mentioned the net cash flow.

Let us now focus on the Financial Services business. Our net portfolio in Q1 was up by 3% and the penetration rate was on a level of 39%. The Financial Services operating profit was down by EUR 7 million to EUR 26 million, driven by lower margins, higher operating expenses, and bad debt provisions.

Page number 10. Very briefly, you see sales revenues and returns on sales quarter over quarter comparison. This is for your reference.

If we go to page number 11, you can see that, as I mentioned before, the European truck market developed according to our expectations in the beginning of the year but, as you see, in March it declined significantly. The growth from Brazil slowed significantly as the COVID-19 pandemic started to spread in March. Russia and South Africa also saw a decline in truck sales. Overall units followed the trend and declined by 20%. TGE units, on the MAN side, were once again up, with 10% growth year over year in Q1 2020, but in that environment not continuing the strong growth rate of the last year.

Lastly, bus unit sales were lower by -4%. The European region was slightly down, and we saw a slightly positive development in Brazil.

Go to the next page. Looking at this chart, you have to know that the comparison is not always like for like, as we are mainly heavy-duty trucks, but not exclusively, and a time lag between deliveries and registration might be possible. However, taken as an indicator, it gives us quite a good feeling of how we trend. For Q1 2020, it was already indicated quite a while ago that the European market for heavy-duty trucks was down in the first two months, as expected, and the down trend further accelerated in March. Our unit development was a notch worse, with -35%, largely due to the rollout of the new truck generation at MAN, as planned and discussed before, and the time lags that I mentioned on deliveries and registration. A similar market trend was visible in Germany, where we were down by -26% versus our volumes, -32%. In South America, where Brazil is about 80%, we grew by 4%. Looking in detail into the Brazilian market, the market declined -5%, whereas we increased unit sales by +5% in comparison.

The incoming orders declined, but remained on a relatively stable footing in Q1 2020. Margin in incoming orders in heavy-duty trucks were down about 20% from February. Cancellations were only a bit higher in Q1 2020 than one would expect normally. However, incoming orders in April contracted significantly. Our order backlog should last for several months when operations restart properly and, as we said, we will watch the difficult situation in the European market, as well as other truck markets, very very closely. Our book-to-bill by brand for the first quarter was as follows. Book-to-bill was 1.33 times at MAN, plus 13 basis points better than Q1 2019, followed by Scania on a level of 1.14 compared to the prior year's level and 0.97 for Caminhões e Ônibus.

Page 14 is for your reference only, very briefly on Industrial Business sales revenue and return on sales – you can see again how it developed further aftersales, grew slightly in Q1 2020, with a share of more than 23% of overall sales. We already focused on the levers of return on sales before.

Page 16 leads me to the discussion of the bridge by brand. Sales revenue was down in all brands to a similar magnitude, and ending up to 12% sales revenue decline in Industrial Business. Regarding return on sales, as mentioned in the beginning, Scania was still the most resilient, showing 8.6% return on sales in Q1 2020. Volkswagen Caminhões e Ônibus was at 3.1% and MAN showed the biggest deviation, driven by the effects I mentioned: the introduction of the new truck, an increasing burden of the used vehicle business, and a higher operating leverage.

Let's now focus on financial indebtedness and net liquidity within the Industrial Business. Net financial indebtedness increased by EUR 1.6 billion, mainly driven by the cash outflow of EUR 1.4 million form the end of the domination and profit and loss transfer agreement (DPLTA) with Volkswagen AG for the fiscal year 2019. I think we all debated it at length during the course of the capital structure discussion in the IPO, so you should be aware of that effect. Other than that, you can see in the bridge that there are no bigger unexpected changes and that let us end up at EUR 162 million net financial indebtedness.

If you go to the next page, you can see our leverage ratios, comparing over the quarters and over the year. On the left side, we see that our gearing ratio increased to 1%, as it was negative as year-end 2019, meaning we had net cash instead of net debt. And, in general, we show a strong balance sheet position in the first quarter. On the right side, you see a net debt/adjusted EBITDA ratio, with 0.1 times, only slightly positive. And, again, at the end of the domination and profit and loss transfer agreement (DPLTA) with Volkswagen AG for the fiscal year 2019, it is mainly explaining the change in those ratios.

From the overview now to the Financial Services business. You can see here that sales revenues at March 31 were up 6%, with return on sales at 12%, as operating profit decreased by 21% to a level of EUR 26 million. Some more details about the decline in operating profit: you know, our portfolio growth was positive, but there was a negative effect, first from lower margins and second from higher operating expenses, in particular for IT, for example, and partly due to an increased share of bad debt provisions. Because of the coronavirus outbreak, our customers' payment ability has started to deteriorate. We are working closely together with them, to support them in these tough times.

On our next page, our year-over-year net portfolio growth on a sequential basis declined by 6% versus year end 2019. The main driver for the decline was the exchange rate. The penetration rate was sequentially down by 257 bps, to 39% in Q1 2020, and the Financial Services book value of equity decreased compared to year-end, to EUR 933 million, compared to EUR 971 at year end 2019. Again, here, exchange rate was the effect.

We now continue with the last section of today's presentation before the Q&A, giving a status update in a heavily volatile time. The environment continues to be characterized by substantial uncertainties regarding the duration and severity of the disruptions. As stated in the beginning, the impacts resulting from COVID-19 on customer demand, the supply chain, and production can currently not be accurately forecasted. And, consequently, an updated prognosis on all business developments in 2020 is still not possible. We need now to see how April is coming in, and most probably also May. The second quarter, with the ramp-up of the production, will give us a better feeling on how the markets will develop overall. Nevertheless, we expect a substantial decline in unit sales for the current quarter, and this will for sure affect all KPIs. There are another two topics to mention at the bottom of the chart. Regarding the proposal to acquire all outstanding common shares in Navistar, there is nothing to be added to what has been publicly stated on January 30th, and a merger squeeze-out of the non-controlling shareholders of MAN SE is planned, as publicly stated on February 28th.

On the next page you see the outlook on markets. We did not yet reflect in here how COVID-19 will have an impact. You can see widely from ACT and from everybody that it's a crystal bowl, and we need to see what the second quarter tells us, to see the outlook for the remainder of the year. So, slide 22 and 23 do not contain any updates. With that, we are happy to take your questions, and I would like to hand back to Rolf in order to facilitate the discussion.

Q&A

28:58 Rolf Woller

This time it's a little bit different than usual. I will try to moderate the Q&A session with regard to the questions.

30:02 Operator

The first question is from Klas Bergelind, Citi. Please go ahead.

30:09 Klas Bergelind

Good afternoon Andreas and Christian. It's Klas from Citi. I hope you are both safe and are keeping well. The first one is on the margin at Scania, the exit rate. If I back out the currency, I get the drop-through of operations was around 40% on a 10% organic sales decline. That's a big bigger than I thought. It's despite after sales and services being strong in the quarter. And there's no major impact from capitalization of R&D. And I get that you have write-downs on the second-hand trucks, but that should be a little bit more on the MAN side. So, my question, really, is, I'm trying to get a sense of that margin in March, the exit rate at Scania – is that a break-even number or better? I will start there. Thanks.

31:01 Christian Schulz

I think, if you look at both, you can say that, even without corona, MAN would have been negative. So, you can consider 50% of what you see in Q1 on the MAN side as being an effect of the COVID-19 market decline. On Scania, I would say it's a bit better than breakeven, and they're managing very well. As you say, there are a couple of effects when it comes to used trucks. That's also in the bad debt increase that I mentioned in Financial Services, but overall you can see that Q1 2020 was still very substantially positive on the Scania side. MAN was a little bit more affected, of course, given the situation they were in anyhow, with the ramp-up and the issues around, that that we have discussed before, Klas.

31:49 Klas Bergelind

Thank you, Christian. My second one is on orders and deliveries at the start of the quarter. Two questions in one, I suppose. It seems that orders in April must be trending down at 60%. Could you please break that down between Europe, Brazil, Asia. I am guessing Emerging Markets in Asia are very strong, Europe maybe near zero, Brazil down 70–80%. And then on deliveries, you say that you have a backlog for a couple of months, but deliveries undershot my expectations and can be down more than what the backlog suggests, as big a part of Europe is closed for business. So, a ceiling also for deliveries in the beginning of the quarter would be great.

32:30 Christian Schulz

Well, you know, giving detailed outlooks here is difficult. I would rather like to have that myself, to give the capital market an update on the prognosis. Generally, you can say that we see the Asian markets recovering a bit, with an increasing demand from Taiwan, Korea, and China. That gives some positive feeling from that end of the coming months. We currently, as you have rightly said, see a significant reduction in margin, with April also being very difficult. When it comes to order intake, as we have stated in the press call this morning, we see stability in the order program for a couple of months. Now, is it three, four, five months? Quite honestly, it's hard to tell. And, as I said before, we need to say how April and May go. One thing I know for sure is that Asia has a little bit more on the Scania and MAN is a little more focused on the European market, and thus has a little bit more difficulties from the market side, as you have rightly estimated.

33:31 Klas Bergelind

My very final one is for Andreas on fleet renewals, which you talked about during the press call. What is the feedback so far from the governments versus you guys now lobbying for it? Just to get a sense of what the order of infrastructure investment is in tunneling or road network versus truck renewal programs – where would we see it? It's obviously a very solid proposition, but just to get a feeling of the feedback in your discussions with the different parties.

34:01 Andreas Renschler

First of all, it's not only for the investment in trucks that we recommend it to the different governments on a European level, and also on a German level. It's a program that will help to increase the investments in the different areas. It could be in equipment, machinery, or whatever else. I believe that a lot of countries have managed this pandemic, form a health point of view, pretty well. Now, we can argue back and forth, but basically we see in all these areas decreasing numbers, so they have done pretty well. And we have to have the same intention when it comes to the economic situation to ensure we are not going into a real recession. So, for that, my recommendation today is: look at investment contribution to all of these industries. And one part of it could be, for us, a truck renewal program, so that we can increase the number of trucks, with the Euro 6d standard in this case, so we can really improve the CO2 and NOX emissions at the same time. That means we can do something for the overall climate but at the same time we see there a potential. If we are looking at it from the investment industry's perspective, that we are not postponing investments, that we are pushing them, that could be a good driver for economic situation. So, from my point of view, this makes some sense. So, it's not only for us; it's for the overall investment industry, and we can do in addition something to renew the old fleet. And I think part of the fleet in Europe is still Euro 3 up to Euro 5, so we have some potential there.

The reaction of the government is so far okay. They listen. Of course, they are more focused on how they can solve the issues at the moment, but they are starting a discussion. They are having intensive discussions about that, and we will see what the next couple of months bring in this field. So, there is a kind of willingness. And I am not judging how China judged with the pandemic overall, but how they are doing in terms of supporting the economic situation at the moment could be a kind of good indication for our governments to do certain things.

36:53 Klas Bergelind

Thank you.

36:58 Operator

The first question is from Hampus Engellau, Handelsbanken. Please go ahead.

37:04 Hampus Engellau

Thank you very much. Three questions from me. Maybe starting off on MAN and the drop in the quarter. I guess that most the run rate was planned, maybe 50% drop in Europe this year. Would it be possible for you to discuss the drop just for the launch cost, and maybe if you could also quantify the launch cost? The second question is on backlog and also order intake. How were the cancellations in April? How much of the Q1 orders were cancelled in April? Did we have customers wanting to postpone delivery? Or how should we think about that? And the last question is more related to the Service business. I know the service developments during the first quarter, but we have heard rumors of activity being down 50%. How does that correspond with your view of the Service business looking at April? I will stop there. Thank you.

38:14 Christian Schulz

Thanks for your questions. First, I will say, on MAN – and I tried to said it before – that without corona, if you take out 50% of the loss in Q1 at MAN, that would have been the performance. We do not communicate on a detailed level what is operating, what is ramp-up cost, like we have discussed before. But you can say that the operational performance without corona would have been on that level. When it comes to the orders, these are net orders. That means that the slump that you see already in April was on the level that we have discussed in Klas' questions, on the level of 60–70%. And now the question is: what will April and May tell us? We have seen a couple of cancellations, but not in a magnitude yet.

And the third one on the Parts and Service business, obviously if you have less transportation, you also have a certain effect on the aftermarket and parts business. Of course, on the level of Scania, performance in parts is always a little bit higher, given the high level of vertical integration in that. The impact now needs to be seen also. If Europe is ramping up again in production and everything, and then you see how the trucks are moving, that will for sure also then give us some information on how the parts and services business: if it's going to improve or remain on the current level.

39:36 Andreas Renschler

I think it's very important to know we are looking, with our connectivity, to a lot of trucks and how much they are used. And at the peak of the crisis in Spain and Italy, 40% of the trucks were not running. In the meantime, this has improved already. It went to 35%; I think now it's between 20% and 25%. With this number, as it will increase, you will see a recovery on the Service as well. So, everything depends on the economic development. If there is no transportation need, for a full fleet, for a European fleet, then we will have some issues with service as well. But at least it looks like when they are re-starting

– also in Italy and Spain – that we will see some more mileage from the trucks again, and that will help us also, of course, in the Service business.

40:38 Operator

The next question is from Damien Flowers, Commerzbank. Your line is now open. Please go ahead.

40:44 Demian Flowers

Hi. Thanks very much for taking my questions. The first one is going to be on working capital. So, now that the plants are re-opening – and I think you've given us some good information about how the mechanics for that are working this morning – that should be a key step to helping you limit your cash burn. Can you talk about how the working capital has developed since the start of the Q1 was okay, and how do you view the working capital risk for the upcoming quarter? And then, secondly, on the dividend, how do you think about paying this year's already declared dividend? I think Volkswagen is a bit unclear on what exactly it's going to do. Could you confirm that you will still pay it when the AGM is finally rescheduled? Thank you.

41:37 Christian Schulz

Question 1: we improved working capital last year, in the second half, as you can see. Inventories, in particular, went down. In Q1 now, we saw that we managed, on the ordinary business in January/February but, as I said before, the used truck environment continues to be challenging. And because of this we already saw now in March certain effects. Despite all measures we are taking at the moment, with the ramp-up of production we see the biggest drain on the working capital side in Q3 2020. Of course, it's very high on the agenda, in the brands and also in the truck board. But having all these ramp-ups in MAN with the new truck and everything, and markets coming back, we expect in our current scenarios most probably for Q3 to be the hardest on the working capital side.

When it comes to the dividends we have indicated, as you know, the AGM will decide about the dividend payment. We do continue to keep it on a level of 30%–40% of our net income. We will propose this for discussion and then, at the AGM, once it's taking place, we will decide on that.

42:52 Damien Flowers

Okay. So maybe just a follow-up, briefly. So, on the P&L, would you see the maximum launch cost impacts in Q2, and then on the cash side in Q3?

43:03 Christian Schulz

It's not only the launch, because it was an example for the working capital ramp-up. In general, you see that our plants have been down. We are ramping up currently during May. We need to see if there's a second dip from the infection rate that will lead to more restrictive production. And then, most probably, if the market is coming back in Europe to certain levels, if then the production is ramping up, if you have your supplies, if you have the launch costs in MAN, you will most probably see the highest drain in working capital.

43:42 Operator

The next question is from Daniela Costa, Goldman Sachs. Please go ahead.

44:03 Daniela Costa

Hi. Good afternoon. I wanted to ask two medium- to long-term questions. The first one is: can you update us on your thinking regarding how the MAN Financial Services business has evolved over the last few months? And the second thing I wanted to hear your thoughts about as well is: on the back of some of your competitors' recent announcements, what is your take on that? Thank you.

44:25 Christian Schulz

On MAN Financial Services, we have continued, as we have said, the discussions with Volkswagen, which is currently providing that for MAN. We have made progress there. We are currently assessing on pilot markets where we could do something together with Scania Financial Services. So, those are progressing. Of course, Daniela, you will understand that, with the current situation with COVID-19 and with the ramp-up of the new truck, we need to be careful which markets we choose in order to start out pilot, but the strategy is unchanged. And we are working in this direction and we have a very good exchange with Volkswagen Financial Services on that. Secondly, Andreas, would you like to take the questions?

45:27 Andreas Renschler

As you know, we have a very good alliance with our Hino colleagues. And we believe, of course, in the fuel cell technology long-term, and that's the reason we are working very well together with Hino. As you know, Hino is connected with Toyota, so we are working in the fuel cell business together with the most sophisticated company in this industry when it comes to fuel cell, and that's very good. So, we are fine with that one. We are looking at our global alliance partners and looking into modular systems for all of our different kinds of trucks. And I totally believe that this will be, at least for the next couple of years, the mainstream we are following when it comes to alternative drivetrains – not for all applications, but for a lot of applications. And in addition then, we can see at the end of the century maybe, some other things in fuel cell. But we are looking at that one at a good economic scale already and it's much easier to develop something from scratch instead of using existing one and you have to combine that one. So, in those things, we are well positioned when it comes to potential economic scales in the future.

47:09 Operator

The next question is from Tim Rokossa, Deutsche Bank. Your line is now open. Please go ahead.

47:12 Tim Rokossa

Good afternoon. All three of you – Andreas, Christian, Rolf – have multiple experiences with crises in the past. Andreas, you said this is unprecedented and I think everyone will agree with that, but do you think that the playbook, i.e., your reaction to it and how you manage them, is roughly the same as it used to be before? Or have you taken some steps that you would have never taken in the past and that are new to you?

Secondly, we have had this discussion a couple of times in the past but, when I discuss with investors in light of the prelims that we had already, the biggest disappointment still comes out of MAN. It was a big part of the equity story to turn this business around. Now, you said 50% of the negative development came from COVID-19. That's a very disappointing development on an underlying basis. And I understand that, right now, it's probably difficult to talk about restructuring and you probably don't want to do this at the moment, but what is your thinking post-being back in a more normal situation again? Do you see that the demand for restructuring is increasing? And, also, does this impact the ideas that you had about launching the new truck generation on the MAN side.

And then, finally, Andreas, or Christian: your previous colleague, Martin Daum gave a fairly upbeat interview over the weekend, talking about being back at almost full capacity by the summer already. That obviously doesn't pair too well with you asking for incentive programs on the same morning. I think a lot of people in the industry are asking where he takes that optimism from. Can you help me to understand it?

48:50 Andreas Renschler

Let me answer that last one. It's better that you ask him. I know raw figures, and my statement before that I do not see a lot of positive developments was without incentivization. Incentivization will help the economic situation, and then we will see. It's a different kind of question: "until when can you achieve a certain production utilization?" Christian mentioned before all the backlog we have. And it's not a big undertaking, if you have the health measurements in place, you can achieve close to full production maybe before June or July. But it depends at least on the order intake. And I would not see it like that, so far. It depends on April and May and what happens on the overall economic situation. So, the best thing is to ask him and maybe he can tell you then in detail where he gets it.

You asked about MAN. Our strategy was, and is… first of all we found the organization that has the oldest trucks in the industry. So, we put the first restructuring program in place very early, and then we said, now we have to do much more. That was the first step towards the new truck generation, and this was done successfully with the organization. With this new truck generation, we can change all the processes, and that's still valid besides corona. And this allows us to take the next big step. Of course, it's now a little bit postponed, because if you have the people at home it makes no sense to start this one. So, we are not in negotiations, but we are in talks. We are looking at the developments we will see there in the next couple of weeks and months. This program is already in a working process. This means that we know what to do and we have our ideas, and now we have to look that this comes one step further in the next couple of weeks and months, like I said.

You can always question what is most important. If you have a totally efficient company with another new truck generation, you could not change the processes. So, the question was always, what is more important after the first program? We said very clearly that we needed new truck generation to change processes. And we are looking at the next big step to bring MAN to more competitive views when it comes to profitability.

Your question about the playbook, this is a very, very good question. I have thought very often about it. Of course, you can use some measures you have taken before. But the big difference, and that was the first time in my years of working in this industry, was that the whole world was shut down. Nothing happened any longer. The logistical chains went down. We saw this from a global perspective and this was, of course, something totally new. In the financial crisis, you still had some markets that could deliver, let's say 40%–50% of the demand. But this time it was coming down from an acceptable demand to zero. And that was an experience I never had before in my life. Of course, you can look to certain things and countermeasures we have taken in different crises, and you're right: for the truck industry it's always up and down; we have had a lot of crises in our history.

So, I'm pretty sure we have all measures to overcome this, and we will use some of the things we have experience with, and we will also have to define some new ones. And this is what has brought me to a positive attitude: I saw last week that the plants started up, that we could do it with the supply chain, that we had a lot of suppliers in Italy and Spain producing already, that logistics are starting again, so the motivation of the people is very high. So, we can do it now. It depends not only on the order backlog – that is high, and like Christian said, cancellations are very limited – but we have to look at how the economic situation is developing.

The truck business, if the economy is doing good, we are doing good. There's a lot of transportation. If not, and we only have to transport toilet paper for the German customers, it will not be enough for our fleet. So, this is the issue I wanted to raise again. With this kind of economic support, from the whole industry of investment goods, I think there will be a good chance to stabilize the situation.

54:44 Tim Rokossa

Thank you. I really like the reference to the toilet paper. I will check with Martin and let you know what he says, Andreas. Thank you.

54:54 Operator

The next question is from Xingzhou Lu, UBS. Your line is now open. Please go ahead.

55:00 Xingzhou Lu

Hi, Xingzhou Lu, from UBS. Thank you for taking my questions. Firstly, on Scania orders, I think they declined over 60% in Latin America, which is a lot more severe than the market. Was this due to high comps, or due to a weakness being skewed to a more heavy-duty side in Latin America?

Secondly, do you see any delays to the joint common base engine originally planned for next year? And lastly, for MAN, could you maybe comment on the reception so far? I appreciate it's been a tough time, particularly in March, but even before COVID, how have customers been talking about your new truck generation? Thank you very much.

55:45 Christian Schulz

I will start briefly with Brazil. You remember last year we discussed that Volkswagen Caminhões was not improving like Scania was, because Scania is just heavy duty. And this has been turned around this year: the heavy-duty segment has been under pressure. And this is why you see the effect on Scania being higher than what you see for the overall market in Brazil. Secondly, the joint engine was planned for 2021 in Scania, and I think it's coming at it is planned. And this also the part of the investments that we do not touch on. And, finally, maybe you can refer to the new heavy-duty truck and MAN, Andreas?

56:27 Andreas Renschler

The new truck generation was received very, very well. There was a lot of interest from the customer that also came through the order book: so, not only interest; the most important thing is that they ordered. Of course, now we had to postpone the ramp-up a little bit, but in the new kind of ramp-up after the crisis, the slow start of production, we try to fulfill the demand of our customers for the new truck generation, so the acceptance was pretty good. And this new truck helps us, again to change processes. And this is, to me, similarly important as the new truck generation. With these new processes in the sales area and other things, we are positioned much better.

And maybe one word as to Brazil, because you mentioned it: Brazil also has the corona crisis, but the second thing is that they have, at the moment, a political crisis. As you know, the president fired a lot of well-accepted people: two ministers, one of health and one for legal questions.. So, in addition to all these issues with the corona, they have in the meantime a political crisis. We have to watch what will happen there in the next six to eight weeks. This is a very severe situation because a stable political situation will help you much better to handle such a big crisis, and with this on top, it's not easy to foresee what will happen in Brazil.

58:19 Operator

The next question is from Kai Mueller, Bank of America. Please go ahead.

58:26 Kai Mueller

Hi. Thank you for taking my questions. The first is on the used truck pricing that you mentioned. You said there has been significant pressure that you have seen from that. Can you give us the magnitude? And what is really the driver? Have you seen that even before COVID, or is COVID really the starting point of that pressure?

The second point is on your dealership network. We have obviously seen in the automotive industry many dealers struggling under the current lockdown situation. Have you had dealers asking for help on that side? Would you then help with some sort of working capital terms, potentially?

Another question that was asked earlier, but I would just like a clarification. On your aftermarket business, we have obviously heard one of your peers saying aftermarket revenues will go down over the coming quarter because of little activity. Can you give us a little bit of a magnitude? I know you mentioned Spain as an example in terms of how much it was lower. And then we saw that ramp-up. Should we expect that to be hurting your margin again in Q2, and maybe also all the way into Q3 and the back-end of the year?

59:47 Christian Schulz

Let me take the aftersales first. We also see it coming down. We do expect 10%–15% over the next quarters but, as I said before, it depends on how the market will come back in Q3 and Q4 and on if transportation, as Andreas has rightly said, is going to pick up. But 10%–15% is something that we would maybe imagine in current scenarios. When it comes to dealers, we have a way higher range of captive dealers within Scania, but also in particular some of the captives in MAN. For the non-captive, we see rescheduling, of course, as we see with other customers. That's one main impact. And when it comes to financial strength and liquidity, we are in discussions with our dealer network operations. I think we are still handling it very well at the moment and do not see more effects there. One way or the other, it might come there on the agenda, but it is monitored by our dealer network management.

For the used trucks, you saw in Q3–Q4, when you look at our inventory documentation that we put on our website, that it was a little bit of a trend that used trucks was going up with markets being closed, in particular in the Middle East and on these ship routes. Of course now, with the situation in the transportation industry, we have customers that return their vehicles. And, depending on the situation – like Andreas referred to this morning in the press call – and on how you pick up demand, you will also see a correlation to the used truck business. And they're pretty much a European subject. We do see in our scenarios that the ramp-up will go up, like I discussed before.

On the working capital question, where we see most probable impact is during Q3. And when it comes to market pricing, there are a couple of external analyst companies where one can see how different the tractor prices are between main competitors. I do not want to refer to our competitors here, but this data is available. There are some differences when it comes to the tractors in long-haulage highway, but we are all coping with the same issue, basically. The question is: how to you assume the market will continue?

01:02:10 Kai Mueller

Very helpful. And maybe just to follow up on your truck business. In MAN, obviously with Scania, you own the Financial Services. How is the risk-sharing with the VW Financial Services and your MAN business? Are you taking all the hits in your MAN business, or is there a sharing agreement in terms of defaults or delays in payment?

01:02:29 Christian Schulz

We take it.

01:02:34 Kai Mueller

You take it. So, the Volkswagen are simply a finance… and are not taking the risk.

01:02:34 Christian Schulz

It's a bit more complicated than that, but that's the nutshell, yes.

01:02:34 Andreas Renschler

I've decided in my next life I will also be in the Financial Services area, with no risk and have a lot of money.

01:02:59 Operator

And the next question is from Jose Asumendi, JP Morgan. Your line is now open. Please go ahead.

01:03:04 Jose Asumendi

Thank you. Andreas, can you talk about two topics, please? The first on MAN, you mentioned the measures you are taking on the brand. Could you give us an overview, please, of some of the structural measures you plan to take to improve the profitability, as much as you can talk about headcount reduction, or any measures you can take around this topic?

Second, can you talk a bit about the Navistar collaboration – where do you stand on the collaboration with Navistar, and as you think about a potential full merger, are there any projects you think you are not able to achieve in the current shareholder structure? Or do you think you will be able to tackle all of the projects? That would be the second one.

The third question: could you help us a bit on the leverage in the second quarter? I know it's difficult. Obviously, it depends on the outlook and the market, demand, etc. But can you talk a bit about leverage and which levels you feel comfortable with and what kind of scenarios you are thinking of for 2020?

01:04:22 Christian Schulz

Let's take the Navistar first. As we have discussed, the alliance project continues to go very well. We discussed last year on the [inaudible] on the component, and nothing that is on the table there is impacting on the other discussions. The alliance project is going to continue as it is planned. As we said before, the offer is on the table. There is no new information currently, and please understand that we do not communicate on running discussions and transactions.

When it comes to the third quarter, I would love to have my sales and revenue for the next two quarters identified. We work with scenarios. Obviously, among those we are looking at are the ones that Andreas explained this morning, with the V-shape, L-shape, and what that means for operating leverage in Q3. Given all indicators we see at the moment, it's most probably in a negative direction somehow, but it's very difficult to make forecasts there.

01:05:23 Andreas Renschler

On MAN, like I tried to explain a little bit before, we started with a restructuring program called PACE. After that, we moved to the new truck, and the new truck generation allows us to improve the costs in a lot of areas. Basically, it's very important in this case, when I'm talking about process changes, that it gives you a kind of direction. The majority of what we will be doing will be in the indirect or white-collar area. Because of the new processes, we are able to be a lot more efficient and have a different kind of potential there.

So, the majority of things we are doing are in the indirect or white-collar area, but we still have to look in other fields as well. We are still in talks with our labor representation. Now it was postponed a little bit because of the situation we had the last two months. They are working further on it, and hopefully very soon we can announce this and tell you in detail what kind of measures we will take. But, basically, the majority will be in the indirect or white-collar area.

01:07:08 Rolf Woller

Thank you very much. Thanks for the very lively discussion we had. These are interesting times. I hope that you are all staying healthy, and we are looking forward to answering any questions that might pop up in the aftermath of this call. You will hear from us later when we announce our half-year results on July 31. Thank you very much. Enjoy the rest of the day and a good rest of the week.