Q&A session transcript from Kitron ASA CMD 2016-02-11

Peter Nilsson, CEO Kitron ASA: So with that our presentation portion is complete. We will end our webcast at this point and open up the floor for some Q&A. Thank you so much everybody watching at home on the webcast.

All done? Ok. Good! We are offline. So we will open up the floor for any Q&A, for anybody on the team.

Guest 1: I'm just trying to understand the order backlog. To me it seems like its very long term. But that leads me to believe that it must be: One part is very long term and some of it is short term.

Peter Nilsson: Yes!

Guest 1: Can you try to explain it?

Peter Nilsson: It's very simple. We've consistently measured the order backlog the same way for years and years. And the order backlog consists of all of the firm orders we have plus the first four months of forecast. So for some business sectors, take an example, would be; industry for example, the firm order horizon is short, even with some of our medical customers our firm order horizon in the worst case is 24 to 48 hours, something like that. That's when we have a firm order. But what we do have is a forecast with them. So in that case we always look at the first four months of forecast plus any firm order we will have. Which would be for example the Defence industry, the firm orders could be very far out into next year. We could see part of our order backlog now could cover some products for next year, but usually not beyond 2017. I cannot confirm it but I don't think we have a lot in our order backlog that's beyond next year. Most of it is actually concentrated in this year. But internally also, we look at other numbers. Every week we look at our rolling six month demand and how is that correlated to our growth plan. And I'm happy to say we are on track. So did that answer your question? 06:21

Guest 1: Yes, it did. But would you say that your visibility goes far beyond your order backlog then?

Peter Nilsson: Yes, because again what we include in our order backlog is only forecast for the nearest four months. We have forecasts nine months out, twelve months out and so forth. The problem with forecast is that is tends to drop off somewhere in the ninth to twelfth month horizon. There are no customers forecasting volumes for 2017 for example, other than sort of a strategic demand.

Guest 1: Yes, so my real question is that you are very certain about one year ahead, but then it starts to get a little blurry.

Peter Nilsson: I'm extremely certain for the rolling six month number, right. But we still do not have full order coverage or forecast for every product in the fourth quarter. Some of them, yes, we know what the demand is but the product isn't released yet, so there is nothing to start buying on the material side. So that is really what we use the forecast internally for, is to buy material on long lead time so we can secure supply. Usually we try to buy it as close as the actual requirement date is possible and of course to increase inventory turns, push down inventory, boost our return on operating capital. Tommy:

Tommy P. Storstein, Sales Director Kitron ASA: Take for example the SAAB contract, which we have announced 400 million NOK for 20 years. That doesn't mean that the 400 million NOK is included in the backlog. Due to the definition … it is four months forecast. But we have a horizon for 400 million, but it's based on the firm orders.

Peter Nilsson: So all of these large contracts values we announce the 100 million NOK here, 400 million there, 200 million here, usually that's out there. It hasn't started yet, most of it. Probably the earliest it will start is in 6 months. But it is usually beyond that and usually it's not part of our order backlog. The order backlog will reflect where we are right now. Any other clarifications, questions?

Guest 2: Being internationally oriented as you are. How do you focus the currency risk that you at some point must have?

Peter Nilsson: Why don't I let Cathrin answer that question?

Cathrin Nylander, CFO: What we do is how we write the contracts with our customers. So normally we have an adjustment for currency, either monthly or quarterly or annually that adjusts our prices so we see that when our raw material prices go up so that the debt is carried over to our customers. So that is how we more or less handle that part of it. As well as, we have a balanced currency policy, that means that we try to buy up so that we have a balance sheet which is weighted on both sides when it comes to exposure every month. So that means we have very agio and disagio on operations actually during the year. And this year were we see the currency grow it's quite small actually, to be honest. Did that answer your question?

Guest 2: Yes, as far as I understand, is it fair to say that you do have control of the currency situation presently in this market?

Cathrin Nylander: As good as anyone can have it.

Guest 3: I'm wondering about your investment levels. You are reducing your capital expenditure for 2016. Is that sort of the run rate there, is that enough to get you to 3 billion NOK revenue for 2020?

Peter Nilsson: I believe it is. It's also a mix issue. As we grow, as we add more, expand our product portfolio in Lithuania for example, where we have a lot of lines, the product mix will be changing and we will also be targeting much higher value products. We have a lot of high value products there, but we have some that is not so high value, so there's a mix change that is going to happen also over there coming years. You saw around 3.5 per cent capex in the past couple of years, and when you look at our monthly or quarterly basis, our depreciation cost versus sales on capital expenditures on equipment alone, we are way above the industry norm. And we are confortable at a level of 2.5 per cent about or so of capex versus our top line. Which is pretty much 1 per cent above our competition in general. They tend to be around 1.5 per cent. Some of our Nordic competitors, you look at the results they presented for the past couple of years, they are under one per cent, which doesn't bode well for the long term. But for us, we are confortable where we are at, and we don't argue a long time when it comes to any investment. We look at what's needed, what's the best thing in the market. And my guys here can vouch for that, because I sign off on everything and they work the background trying to find the best equipment available. But whenever something is needed and it can generate a possibility for us, we put it in place. But without wasting money. And we try to minimize risk a lot.

Guest 3: So just one more. Are you factoring in a full rebound for the Offshore and Marine sector in order to reach your targets?

Peter Nilsson: We are not factoring in any growth in the oil service industry in our plans at all – at all. There are not a lot of prospects on the list that are part of our growth structure. I'm just happy to say that we recently have seen some indications that we may increase our service part of our business there instead. Which is interesting for us and it generates better profits for us, but it doesn't contribute a lot to the top line.

Guest 3: One finale one**.** So your sales target is to grow by 10 per cent annually and then you have a 10 per cent target for existing customer and 5 per cent for new customers. Is it 10 per cent for the existing customers including attrition or is the actual target 15 per cent?

Peter Nilsson: Well, the overall target is 10 per cent including attrition. But for existing customers there is going to be attrition and the 10 per cent there is to continue to grow them and then of that 10 per cent growth, anywhere from 0 to 5 per cent is usually attrition also. Let's say on overall basis, I don't know if we are at 3 per cent attrition, maybe something like that, usually products going end of life. And next generation coming in, us winning that but cost of next generation is lower. So obviously you need more volume and more growth to compensate for the price erosion between generations.

Guest 4: With respect to service and after sales, do you see differences with respect to different sectors on where the potential lies?

Peter Nilsson: I think currently – I see a lot of growth across all sectors – but currently probably the Defence sector generates the highest service sales and the primary reason in 2015 and as we move in to 2016 is the launch of the different, let's call them, what are they called? They are not the generations of the F-35 but the different…ah?

Hans Petter Thomassen, MD Kitron AS: Conversions or are you talking about the different development stages?

Peter Nilsson: Yes, exactly. We passed from LRIP 8 to LRIP 11 now. And between each stage there are developments on the product where they actually work on cost reduction or changing the product. F-35 is not a static project at all. I think up towards 12 or 13 it's going to be a completely changed out. And then we are talking a time period 2020–2023, somewhere around there. And each of those changes means a lot of work on design and test development and verification for us, and that generates a lot of sales for us, and primarily in our Norwegian operations, and a significant portion of Arendal sales. Arendal is today I think above 10 per cent on service sales, if we look into last year. They have been doing this for a long time, but last year was really the first year it actually generates profit. One thing is doing something, another thing is doing it and making money. And they are doing it now and making money, which is a change we are also doing across all of our plants now, where we track each plant on a triple P&L. So we look at how do they manufacture, what's the P&L for that manufacturing site? What's the P&L for the design and development and services portion? And if they work with trading, like Sweden does a lot of trading from China, where they buy China-produced and sell it in Sweden, what's the PNL for trading? So that we understand where margins come from and not let something else subsidise another portion of our operations. So, I think the question was does a lot of it come from Defence and yes a lot of it does come from Defence, but we do it all over the place. There is not a lot of Defence manufacturing in Lithuania, but last year when we inaugurated the facility, we also took the decision to invest heavily in development services in Lithuania. I don't know if we have 7 or 10 people now that are trained an up and running and starting to generate money. Last year I think was more of an investment than generating cash for us. So we will be able to offer comparable services from Lithuania and there the targeted customer base is industry.

All happy? Thank you so much. It's been my pleasure to have you here today. I'm so happy to see so many customers, and I saw a couple of suppliers here, investors and shareholders, board members, employees. Thank you so much!

Kitron ASA

P.O Box 97, NO-1375 Billingstad, Norway, Visiting adress: Olav Brunborgsvei 4, 1396 Billingstad
Tel.: +47 61 10 00 00, Fax: +47 67 10 64 61, E-mail: info@kitron.com , Enterprise no.: 976 605 713
www.kitron.com