NFI Group (2022 Q2 Results)

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Corporate Speakers:

- Stephen King; NFI Group; Vice President, Strategy and Investor Relations
- Brian Dewsnup; NFI Group; President of NFI Parts
- Pipasu Soni; NFI Group; Chief Financial Officer
- Paul Soubry; NFI Group; President & Chief Executive Officer

Participants:

- Chris Murray; ATB Capital Markets; Analyst
- Cameron Doerksen; National Bank Financial; Analyst
- Kevin Chiang; CIBC Capital Markets
- Maggie MacDougall; Stifel; Analyst

PRESENTATION

Operator^ Good day, and thank you for standing by. Welcome to the NFI second quarter 2022 Financial Results Call. (Operator Instructions) Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your speaker today, Stephen King, Vice President, Strategy and Investor Relations. The floor is yours.

Stephen King^ Thank you, Carmen. Good morning, everyone, and welcome to NFI Group's second quarter 2022 results conference call. This is Stephen King speaking, and I'm pleased to have with me today returning President and Chief Executive Officer, Paul Soubry; Brian Dewsnup, President of NFI Parts, and our acting President and CEO during Paul's temporary leave; and Pipasu Soni, Chief Financial Officer.

Today, we will walk through our quarterly results and provide our outlook for 2022 and beyond. This call is being recorded, and a replay will be made available shortly. We will be using a presentation that can be found in the Investor section of our website, and we will be moving the slides via the webcast link, and we will also call out the slide number as we go through the deck for participants on the phone.

On this morning's call, Paul will give us a brief update on his return. Brian will walk us through milestones and major activities from the quarter, and then Pipasu will discuss our financial results. Paul will close out with our outlook.

Starting with Slide 2, I would like to remind all participants and others that certain information provided on today's call may be forward-looking and based on assumptions and anticipated results that are subject to uncertainties. Should any one or more of these

uncertainties materialize or should the underlying assumptions prove incorrect, actual results may vary significantly from those expected.

Please also note that certain financial measures used on today's call do not have standardized meanings prescribed by International Financial Reporting Standards and therefore may not be comparable to similar measures presented by other issuers. You are advised to review the risk factors found in NFI's press releases and other public filings on SEDAR for more details.

We also want to remind listeners that NFI's financial statements are presented in U.S. dollars, the company's functional currency, and all amounts referred to are in U.S. dollars unless otherwise notes.

On Slide 3, we've included some key terms and definitions referred to in this presentation. Of note, zero-emission buses or ZEBs, consist of battery electric, hydrogen fuel cell-electric and trolley-electric buses. Equivalent units, or EUs, is a term we use for both production slots and delivery statistics. The majority of our vehicles represent 1 equivalent unit, while an articulated 60-foot transit bus takes 2 production slots and is, therefore, equal to 2 equivalent units.

On Slide 4, for those of you new to the NFI story, we are a leading independent global provider of sustainable bus and coach solutions. We are leaders in our core markets, which includes heavy-duty transit coach and Aftermarket in North America, heavy-duty transit and Aftermarket in the United Kingdom and the world leader in double deck transit buses.

Turning to Slide 5. Our purpose and mission is simple. We exist to move people. Very simply, our products transport precious cargo. We are focused on designing, building and delivering exceptional, safe and turnkey mobility solutions. We made our sustainability pledge in 2006 and it still holds today: a better product, a better workplace, and a better world.

We have implemented numerous of ESG advancements, full details of our ESG initiatives, including our diversity, equity, and inclusion survey and our materiality mapping exercise, were outlined in our fourth annual ESG report, which was released in May 2022 and is available on our website.

Slide 6 is critically important as it shows the breadth of our full offering. NFI solutions include vehicles, charging infrastructure, connected buses and coaches, telematics, Aftermarket parts and service and financing solutions. We are truly a partner of choice for bus and coach customers, offering comprehensive and customized evolving solutions.

I'll now pass the call over to Paul.

Paul Soubry^ Thanks, Stephen. Good morning, everyone. I'm on Slide 7. It is great to be back after a brief medical leave and taking time away these past few months to focus on

my health. It's been very important. I am truly grateful to Brian Tobin, the Board of Directors and Brian Dewsnup, my fellow executives, and the entire NFI team for their continued hard work and dedication during my absence.

I am pleased to report I'm down 21 pounds, not quite at my wife's target yet, but I'm on track, and I've been cleared by my health care team to return full time with a plan in place to ensure my continue well-being going forward. My deepest thanks, Brian. Dewsnup, President of our NFI Parts business, for running his business and stepping in my shoes for leadership and guidance as acting as President and CEO for my absence.

NFI was in great hands with Brian and the rest of the exec team as they navigated through the temporary buildup of work in process inventory and completing amendments to our credit agreement. As I have just returned to work yesterday, it's probably more appropriate for Brian to walk us through the highlights of the quarter.

Over to you, Brian.

Brian Dewsnup^ Thanks, Paul. Turning to Slide 8, we'll summarize the quarter. Q2 was similar to Q1, with continued impacts of global supply chain disruption and heightened inflation. While our results reflect these realities, they also highlight the strong demand for our market-leading products and services.

In the quarter, we:

- received new orders for 1,348 EUs,
- recorded a book-to-bill ratio of 158%,
- grew our backlog by 9%, up to 9,674 EUs with a total value of $5.5 billion, and
- had another 1,098 EUs in bid award pending, which means we've been notified of an award by customers that await the formal contractual documents. Once they're received, they'll be recognized as awards in the third quarter. So, we'll see another period of significant awards and new orders, which we expect to deliver more backlog growth.

NFI has not only been successful in securing new orders, but we also witnessed our North American public bid environment continue to grow. At the end of the second quarter, there were 7,582 EUs in active bids, out for procurement and 29,147 EUs in our total North American focused Bid Universe, which measures active bids, plus a 5-year outlook for demand based on agency and operators' fleet replacement plans.

On the zero-emission bus front, we received orders for another 325 EUs, representing 24% of new firm and option orders. Our total backlog is now made up of 1,900 EUs of zero-emission buses, which equates to a record 20% of total backlog. 11% of our deliveries in the second quarter were zero-emission buses compared to 8% in the second quarter of 2021, and our total public Bid Universe is now 51% zero-emission. All signs that the transition to zero-emission buses is well underway and will continue to advance.

Our Aftermarket business saw a revenue decline year-over-year with the second quarter of 2021, being a difficult comparative as we delivered record revenue in that period with a major retrofit program in Asia Pacific, plus tightened sales in North America. We will see continued volumes from that retrofit program in 2022, but at a lower run-rate than we had experienced in 2021.

The second quarter saw some improvement in certain parts supply-related challenges, with the majority of disruption and missing components coming from electronics and microprocessor related components. While there have been issues, our sourcing and supply team has been doing a masterful job navigating through these challenges and creatively mitigating issues as they arise. We will provide an update on our module shortage with buildup and delivery plan in a later slide.

Turning to Slide 9. We highlight some of the major wins that our teams have achieved in the quarter, including 733 EUs added the backlog from the Toronto Transit Commission or TTC, our first major win in that market in over a decade. In addition, we continue to secure numerous smaller EV awards growing our battery into fuel cell-electric footprint throughout North America and the U.K.

During the quarter, the TTC issued findings from their electric vehicle evaluation program, which found NFI's battery electric buses delivered the highest performance when compared to two other vehicle manufacturers across a wide range of evaluation criteria.

On Slide 10, we show our backlog in second quarter 2022 deliveries. We saw another quarter of backlog growth with firm orders representing 45% of our backlog and option backlog extending to 2027, providing both near and long-term visibility. In total, our backlog grew by 9% from the first quarter of 2022 and 18% year-over-year.

At the bottom of the slide, you can see that all our segments experienced year-over-year decline in deliveries. This reflects the supply chain challenges we saw in 2022 that we did not experience through most of 2021.

We've added Slide 11 to provide an update on the impact of inflation on our backlog. At the end of the second quarter in 2022, firm orders were 45% of our backlog, while option orders were 55%.

Generally, our firm orders are manufactured and delivered within 12 to 18 months of an award being received. When we make our original bids, we will attain pricing for approximately 50% of the vehicle’s components from our suppliers, as they are often specified by the customer. For many other non-specified components, we'll use internal sources, including Carfair for fiberglass and KMG for things like metal fabrication, electrical kit assembly and plastic thermal forming.

We make estimates for inflation between the time of award and manufacturing in our contracts. Given the rapidly increasing levels of inflation and surcharges being passed on

to outside suppliers, actual costs have exceeded our estimates on some firm contracts bid prior to 2022. For the contracts impacted by this, we've been discussing price adjustments with customers and are also negotiating relief with suppliers wherever possible.

During the quarter, our New Flyer business launched a detailed program with surcharge letters distributed to customers, who have fixed contracts, who did not have purchase price index or PPI costs, reflecting the price increases we've seen from suppliers. We have seen success with these efforts, and we expect they will help offset some of the margin pressure we're facing.

Our financial guidance for 2022 reflects the adverse impacts of inflation with improved margins anticipated in 2023. We've also been working closely with customers in various jurisdictions to discuss prepayments or deposits on vehicles that have and will help alleviate some of the working capital investments required by NFI. We've seen success on these initiatives, with some large deposits already received and other customers investigating potential prepayments.

For vehicles and Aftermarket parts contracts that are currently being bid, we've increased the inflation adjustments in our contracts to reflect the macro environment and increased pricing and surcharges we're seeing from suppliers.

Inflation on option orders is a different situation. For the majority of our option orders, when a customer executes on an option, there's a re-pricing that factors in producer price indexes, PPIs for short. Contracts that have PPI adjustments will add a price increase when the option is awarded, which helps us include the impact of inflation in the future contracts that protects our margins from downside inflationary pressures.

On Slide 12, we provided a summary of the workaround plan to address our microprocessor shortage, discussed in detail on last quarter's call. As per the plan, we're building and holding vehicles that are missing a specific control module as we await supply of microprocessors that will be installed into the module, at which point the buses can be completed and delivered.

Turning to Slide 13. This module workaround plan has been proceeding well to both our plan and schedule. We have produced approximately 117 buses, which are parked in secure locations and are complete, save for the addition of the required modules. These vehicles added $57 million to our total WIP at the end of the second quarter.

In July, we continued to build up module related WIP as we await a large delivery of microprocessors in August. Our team has been meeting regularly with both the module supplier and the microprocessor supplier, and we've been assured that supply is on target over the next few weeks. Once the modules are received, the installation of the new modules will take approximately 4 to 5 hours of service time per bus. These fully completed buses will be driven to customers where they will complete a final inspection and ultimately be recorded as ready.

We anticipate that the work-in-process buses will start to flow to customers later in August, with nearly all being delivered by year-end. We may see some vehicles get delivered in early 2023 and anticipate significant cash conversion from these vehicles in 2023 Q1.

In addition, the team has also been developing our next-generation control module, which will use a different more readily available microprocessor. This new module is now in production and is being installed on some new vehicle, too. The new module provides additional supply redundancy and helps lower the risk of future disruption.

As Pipasu will discuss shortly. NFI has more than sufficient liquidity to support the temporary buildup of work-in-process inventory as we execute on this plan.

On Slide 14, we provided an update to the supply chain challenges the company has been experiencing and mitigating. The quantity of high-risk suppliers is decreasing, while the number of high and moderate risk suppliers remains elevated.

This analysis reflects a broader view that while overall supply chains are not seeing major improvements, it appears that we are through the worst of the disruption. We've also seen some initial signs of recessionary impacts in the broader economy, may be helping to lower demand and inflation.

Given the expectation that supply chains will see improvements during late 2022 and into the first half of 2023, we will soon begin the process of ramping up our weekly production run rates. This is not a simple process, and we're taking a measured approach whereby we add production of 1 to 2 additional vehicles a week, with expectations that we'll be able to get back to pre-pandemic run rates by late 2023.

I'll now turn the call over to Pipasu to summarize the financial results.

Pipasu Soni^ Thanks, Brian. Turning to Slide 15, we highlight some of our key metrics. As Brian mentioned, the quarter saw significant challenges from supply chain disruption and ongoing COVID-19 pandemic that led to heightened inflation, lower production and reduced overhead cost absorption.

In summary:

- sales were down 38% year-over-year,
- Adjusted EBITDA was negative $23.1 million, with positive Adjusted EBITDA in the Aftermarket segment, offset by negative Adjusted EBITDA in the manufacturing segment,
- Negative EPS and adjusted EPS of $0.74 per share and $0.64 per share, respectively.

Our ending liquidity was strong at $629 million, an improvement of over $200 million from the last quarter of 2021. Liquidity was down from the fourth quarter of 2021,

representing typical seasonality and a slight increase in work-in-process inventory buildup, stemming from supply challenges.

It is important to note that at the end of the second quarter, our credit facilities required that we maintain a minimum liquidity of $300 million. Under the new amendments, this has declined to a minimum liquidity of $250 million. I'll note that our liquidity declined slightly in July with a closing position of approximately $540 million, reflecting further investment in work-in-process inventory made in July, to address the module shortages that we expect to alleviate starting in late August.

On Slide 16, we reconcile net earnings to adjusted net earnings. In the quarter, net earnings were impacted by the same items that impacted Adjusted EBITDA, plus restructuring costs related to the ongoing closure of our Pembina MCI facility and settlement of a lawsuit.

Offsetting some of these negatives were fair market value gain from our interest rate swaps. We currently have two swaps in place, one for $540 million at 2.27% and another for $200 million at 0.24%. With increases in base interest rates in Canada and the U.S., we had a gain for which we normalize. The chart on the bottom of the slide walks through the normalizations made year-to-date in 2022.

Turning to Slide 17. We are pleased to provide a summary of the amendments to our senior revolving credit facility, also known as the Revolver, and our £50 million revolving U.K. credit facility announced on Friday last week. These amendments come after detailed discussions with all of our banking partners who provided unanimous consent, after reviewing our long-term financial projections and the benefits we expect to realize from demand growth and our cost reduction efforts. Thank you to our banking partners for their strong commitment to NFI.

Under the terms of the amendment facilities, the total leverage ratio (TLR) and interest coverage ratio (ICR) has been relaxed for the remainder of 2022 and for fiscal 2023. NFI will have to meet 3 additional covenants, minimum cumulative Adjusted EBITDA, minimum liquidity, and net debt to capitalization, based upon different time frames as outlined in the table.

There may have been some confusion on the net debt to capitalization calculation. So, just to clarify, this covenant does not include convertible debentures in the numerator, and the denominator includes borrowing on the credit facilities plus shareholders' equity. Details of the amendments to the credit facilities can be found in the press release dated July 29, 2022.

The updated documents will be posted on SEDAR in the near term. These amendments provide covenant relief and additional flexibility and allow NFI to move forward in a stronger position as we ramp up production later this year and capitalize on our growing backlog and order book.

On Slide 18, we provide a brief update on NFI Forward. In the second quarter of 2022, NFI Forward realized Adjusted EBITDA savings of $15 million and an additional $0.8 million in free cash flow savings. We are pleased to report that we now expect to achieve our NFI Forward target of Adjusted EBITDA, savings the $67 million from 2019 levels by the end of 2022, one year earlier than our original target of the end of 2023.

With the majority of the original NFI Forward projects complete, we are now implementing a series of additional projects called NFI Forward 2.0, which is expected to generate additional annualized Adjusted EBITDA savings in 2023 and beyond. NFI Forward 2.0 will be smaller in scale and financial impact when compared to the original NFI Forward initiatives. Expected to generate somewhere in the range of $5 million to $8 million in annual savings from onetime capital investments of $8 million to $10 million.

NFI Forward includes the integration of Delaware Parts distribution facility (a legacy parts warehouse of NABI that NFI acquired in 2013) into our existing NFI Parts footprint during the third quarter of 2022, and the closure of an MCI coach manufacturing facility in Pembina, North Dakota by the end of 2022.

Slide 19 outlines our guidance for 2022. We adjusted this guidance in April 2022 to reflect the year-to-date results and the impact of the module shortages and the heightened inflation on our operations. As outlined on the slide, we reiterate our anticipated guidance of $2.3 billion to $2.6 billion in revenue, with 20% to 25% of manufacturing sales coming from ZEBs, and Adjusted EBITDA of $15 million to $45 million.

We have updated our guidance for cash capital expenditures for 2022, with an anticipated spend of $35 million to $45 million, in response to investments by the Company in electric innovation projects (both battery- and fuel cell-electric) for our ADL business in international markets and other EV growth projects in our North American business.

Turning to Slide 20. We provide some details on revenue and Adjusted EBITDA distribution for the first and second half of the year. We expect that the third quarter, similar to the first and second, will see negative Adjusted EBITDA as that period is impacted by supply chain disruptions and temporary buildup of WIP inventory.

The fourth quarter, however, is forecasted to deliver positive Adjusted EBITDA as we ship buses that were missing modules, benefit from improved battery supply, and see the typically strong seasonality of ADL and MCI from private customer sales.

I'll now turn the call over to Paul to provide insights on our outlook.

Paul Soubry^ Thank you, Brian and Pipasu for the update. I'm now on Slide 21. As we've noted, our public Bid Universe continues to grow, and we now have 4,477 equivalent units of bids in process and another 3,105 EUs of bids already submitted for a total of 7,582 active bids, which will drive new orders and awards in the coming months.

Longer term, we see over 21,500 EUs of potential opportunities as identified by our customers from our 5-year universe. In total, our public Bid Universe is now at new record levels of 29,147 EUs, with 51%, of those being zero-emission buses. Recall that zero-emission buses have driven higher revenue per unit and better margins for NFI.

We have seen some early stats as well on ridership really starting to recover, with APTA reporting an approximate increase of 60% in average weekly transit ridership in the United States, for the first 26 weeks of 2022 as compared to the first 26 weeks of 2021.

We're pleased to see ridership increases as travel resumes, office reopen and people start to move again. This will assist our customers' farebox revenues, lower congestion and emissions. While ridership is very important, keep in mind the primary driver of public trans procurements in the United States and Canada is federal, state of provincial, and municipal funding, which is very strong.

On Slide 22, we've summarized the major investments we've made into public transit by the government in all of our core markets. We've recapped these numbers before, so I won't go through in detail, but we will continue to see the flow of these funds translating into new and larger bids and orders that will drive future revenue growth.

I'll highlight that the Low- or No-emission grant programs, called Low-No, in the United States, aimed at driving zero-emission bus adoption, will see grants of $1.2 billion in the U.S. in 2022, and these awards are expected to be released later in the third quarter. New Flyer was the leading partner on Low-No grants with transit agencies last year for 2021.

On Slide 23, while our deliveries have been suppressed by supply chain disruptions greatly and well described by Brian earlier, our book-to-bill has continued to grow, with the second quarter of 2022 above 150%, positioning us well for the future.

On Slide 24, we recap our 2025 financial targets. Despite COVID-19 and the related supply chain challenges, we remain committed to delivering on those targets. The achievement of these targets does not require fundamental changes to our business. As we already have the facilities, we have the products, and we are already investing in new product development. And we have the service and support infrastructure and parts support business to achieve them.

With improvements in supply chain, we see a clear path to $400 million to $450 million of Adjusted EBITDA by 2025, coming from the growth of zero-emission bus sales. Additional contributions from ARBOC and ADL, continued strong performance of our Aftermarket business, and the realization of NFI Forward savings, which you've already heard about and which is now close to our original $67 million target one year early.

Finally, on Slide 25, we recap the NFI investment thesis. While the past 2 years have been extremely challenged and require that we revise our guidance and recovery expectations. We remain focused on the long-term and delivery to all of our stakeholders. We just announced a very supportive credit facility covenant relief last week. And I want

to add my thanks to all of the syndicate members, 11 banks, which, at the end of the day, provided unanimous support for this new agreement.

We look forward to finishing the second half of 2022 stronger. 2023 looks to be a significant recovery year, as we benefit from the record demand and backlog growth that has given us excellent visibility into our planned deliveries. In fact, in our public transit business, we are now recovering to very close to our original time horizons for preproduction, very encouraging from a supply chain and engineering and an operational perspective.

There have been some positive signs that the worst is now over.

While there are near-term challenges, the tailwinds that support our success continue to increase in both intensity and quantities, new orders, increasing bid activity, recovery of private travel, rising ridership rates and lifting of various COVID-19 mandates, the rollout of government funding and the continued advancement of our zero-emission leadership strategy, will drive NFI's future.

As we close, I just want to iterate my excitement about getting back in the chair, and that I'm looking forward to helping our team complete the delivery of the buses impacted by the module. In hindsight, clearly the right strategy to build, hold and then deliver buses to our customers, and other supply shortages. Our customers, I'll be working with Chris and team on our customers on surcharges and delivery schedule adjustments, and we want to deliver on our strategic goal of continuing to lead the zero-emission mobility for this evolution.

COVID-19 and its resulting supply chain impact has impacted everything. And as I've always said to our team, we're excited about the path we're on and the future in front of us. We lead this industry, and we will see strong recovery in 2023. And that will drive future growth as we get back on the path to our 2025 targets.

We have a great group of people. We have solid leadership that has remained loyal and committed to NFI through the toughest times in our history of our company. Our business leaders, Chris Stoddart, Paul Davies, Brian Dewsnup, and our functional executives have all and continue to drive this recovery.

I'd now like to turn the call back over to Stephen to provide directions for the Q&A portion of the call. Over to you, Stephen.

Stephen King^ Thanks, Paul. I will now open the line for analyst questions. Attendees who are listening via the webcast link can take their questions to management, which we are able to review and read aloud. Carmen, I'll now ask you to open up the analyst questions and provide instructions to our callers.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) We do have a question from Chris Murray with ATB Capital Markets.

Chris Murray^ Turning back to Slide 20 and just maybe looking at the near term and how to walk through this. Guys, I don't know if you want to take this one, but I guess what I'm trying to make sure we're understanding correctly, is just the cadence as we go through Q3 and Q4. And I guess, just your confidence in that supply chain of those module deliveries. Anything else we should be maybe thinking about at this particular point? And I guess along those -- you did talk about some spill into 2023. So maybe if you can elaborate on that a little bit, that would be helpful.

Pipasu Soni^ Let me do this. Chris, maybe just jumping first to Brian because I know he's a little bit closer to the module deliveries, would love to get his input, as well. So let me turn it over to Brian first, and then I can jump in.

Brian Dewsnup^ Okay. Thanks, Pipasu. Yes, as we said during the call, we are on plan from a delivery standpoint. The design of the new modules is coming along really well and the supply. We've been in constant communication, as you would imagine, with both the Tier 1 suppliers as well as the sub-suppliers on getting those modules in for the second half of August. And so that all is going well. We see some opportunities, as well, perhaps in the broker market to supplement that. So we feel like we've got kind of belt and suspenders on that plan.

We work really well with our customers to make sure that the buses were accepted in park. And so the only thing left on those really is the module installation. They'll be on the way to the customers. And then, of course, that will follow with cash conversion a little bit later. At this point, we don't know we're going to have 100% of those vehicles in 2022. As we indicated, we may have some spill into 2023. But the important milestone will be later this month, as we begin to get the modules in and those buses start flowing to the customers.

Pipasu Soni^ Yes. The only thing I would add there, Chris, just to echo Brian's point, is we are starting to see some NXP chips on the broker market to try to kind of help us support our module plan, which we were not seeing as much in the past. So that should at least kind of help solidify that plan that we're looking for this year.

Stephen King^ And, I think, Chris, the only thing I'd add is the cadence Q3, Q4, I would say: obviously, Q4 heavy period, that's where we expect positive Adjusted EBITDA. I think we do expect improvement in Q3 and on the negative EBITDA side, but then Q4 would obviously be the heaviest period as you're looking at the second half of 2022.

Chris Murray^ And then just coming back to a comment about thinking that you're going to have a book-to-bill of above 100% for the next little while, probably through 2022 and 2023. I guess there's 2 pieces of this. One is the demand side, but one is also the production side. So just trying to maybe frame this in a different way. How -- I guess, a couple of things. What are you thinking when you say that, is there a way to think about

like what proportion of your full run rate are you thinking you're going to be able to achieve in 2023 against that number?

And certainly, we can see the funding in transit and things like that. I appreciate that things like coach aren't necessarily in backlog, but it does go into the production rate. How are you thinking about all the different facets of demand as you get into that book-to-bill ratio and we think about the restart?

Stephen King^ Yes. Chris, I'll start, and then I'll pass it over to Brian. I think the way I would think about 2023 and the book-to-bill, obviously, as we mentioned here, we're going to be ramping up production, but it's not a light switch. You can't just flick it on overnight. So it's going to take some time as we add kind of 1 or 2 units a week. We're going to start that in late 2022. So we'll be starting to ramp up of production and then that will continue through 2023.

And so I think what you will see is obviously deliveries will be increasing from where they are this year, as we get into the 2023 in both transit business, in the coach business with private market, recovery ADL business with some U.K. recovery and international markets.

But orders, we expect to continue to be high because as we referenced during the presentation, we get 7,500 units of active bids, which are on the street right now and government funding continues to flow. So, what we've been seeing in 2022, is in a lot of cases, even as those bids get turned into orders, they're getting replaced with new active bids. So we're continuing to see active bids, RFPs, hit the street, and I think our team is as busy as they've ever been in terms of the numbers of RFPs they're pursuing.

So I think all that's to say that our expectation of having book-to-bill above 100% as we get into 2023. I think the first half of the year is driven by continuing to see strong order demand with probably deliveries a little bit lower than where they're going to get to. And then, by the end of the year, we'll see that acceleration of deliveries as we get our production rates back up. Brian, I don't know if there's anything else?

Brian Dewsnup^ Yes, I think it's a great summary, Stephen. And I think the couple of things I'd like to add to that. We talked in the call and we've talked a lot about the funding environment and it's never been better in terms of the amount of funding that's out there. And then we mentioned within the call about this Low-No awards that will get released in August.

And we will see how we fare there, and we expect that will add a fair amount to the order intake, as well. And so when we look at the funding, we look at the Low-No, we feel like the demand side is going to remain strong, and that's what gives us the thoughts and what you see in the presentation.

Pipasu Soni^ Chris, the only thing I would add to that is that I think, exactly what Brian and Stephen said, but a couple of things. We're looking at it again assuming the supply

chain holds that in the second half of 2023, we would start getting back to kind of our full run rate is our thought process, right? And our order book today supports us being able to ramp up to that.

Operator^ One moment for our next question. We have a question from Cameron Doerksen with National Bank Financial.

Cameron Doerksen^ I just want to ask a question about the, I guess, the inflation. I mean, you've given us some good color here at sort of the 45% of the backlog, that's firm that's more exposed to the inflation and you've had some success here it sounds with some re-pricing or surcharges. Is there any way you can maybe quantify what percentage of that firm order backlog would have some degree of, I guess, call it, relief from inflation?

I'm just trying to get a sense of how we sort of expect the next few quarters to kind of look like as you deliver here, and this data puts and takes on cost versus the offset on some of the re-pricing initiatives?

Paul Soubry^ We don't give specific details or exact disclosure regarding the amount of surcharge that we expect to get and what we're working on. But, as we mentioned here, we are working with our customers on surcharge letters and working on payment plans, prepayments and deposits. So that's really trying to go through that 45% of our backlog where we have the inflation exposure. I would say that most of the things where we have that exposure wouldn't be that full 45% because, as we outlined here on the call, there's things that we bid in 2020 and 2021 that we're building in 2022.

And those are probably the contracts where we have the most exposure and the ones where we're trying to work with the customers on surcharges. The stuff that we bid in 2022, they'll be built in 2023, and maybe some into 2024 that's in the firm backlog, a lot of that now reflects kind of today's pricing and we built in the price that's appropriate for the customer.

You can see this somewhat in our slides on Slide 27, you can see kind of that growing average price in the backlog. As you can see, I mean, we're up to $607kon coaches and $600k on transit buses. So, you've seen that increase, and that's to reflect the higher price that we're seeing to reflect inflation impacts.

So I can't give you the exact percentage of that $45 million. But I would say that we're through probably the worst of it, I would say, on an inflation perspective because of the stuff that we bid in 2020, 2021 that's flown through 2022. So that's why we say we expect to see margin improvement in 2023 because we are working with customers on some stuff to get surcharges for 2022, but that's also going to impact 2023 orders.

Cameron Doerksen^ And just maybe secondly, I just want to maybe get a sense of what working capital is going to look like over the next couple of quarters. I mean, obviously, you built up some inventory here, but there's been some onsets on higher payables, lower

accounts receivable. So maybe just talk about the trend you expect from a working capital investment perspective over the next couple of quarters?

Paul Soubry^ I'll start and then I'll pass it over to Brian. So, working capital, I think, you're right there. As you saw, obviously, with deliveries coming down, accounts receivable, we were making collections, and then we expect that AR number to grow as we get deliveries kind of through Q3 and into Q4.

Inventory, obviously, heightened investment right now, $770 million in our inventory with a lot of that coming from that work in process inventory. So the things we talked about with the temporary buildup of the modules, we expect the majority of that to unwind by the end of the year. But, as Brian mentioned on the call, we'll probably see cash conversion more in 2023 Q1.

I think what you will see from us in working cap, a bit of I would say, a working cap investment in second half of 2022, and then a fairly large unwind, I would expect in 2023 Q1. That's kind of the view I would take on working cap. It's probably a bit of an investment in Q3, a bit of an investment in Q4, and then an unwind in Q1.

Brian Dewsnup^ I would agree with that.

Operator^ Our next question comes from Kevin Chiang with CIBC.

Kevin Chiang^ Paul, good to hear you on the call. Welcome back. Maybe just on the AR question from Cam. I saw you sold $32 million of receivables in Q2. Just wondering, is that something you would look to lean on more as you get to the back half here to manage working capital? Or as you make deliveries, I mean, you're dealing with basically AAA customers, and so they're going to pay you? Do you just kind of live with the elevated working capital and just look forward to the cash conversion in Q1? Just trying to get a sense of maybe how you look at that program as you manage through your working cap.

Pipasu Soni^ Yes. So this is Pipasu I'll maybe start on this, and I know Stephen and others may want to jump in. But at a very high level, one of our banks came to us when we did our last credit agreement about potentially doing this. And other banks are starting to come into play. So we will look to leverage that with at least 2 banks hopefully in the near future.

Kevin Chiang^ So that could be an additional source of liquidity, at least from the working capital line versus maybe if I look at historical seasonality, I guess, or something like that.

Maybe just on the supply chain challenges, a lot of great details here. When I look at Slide 14, it's obviously positive, that the high risk line is going down, but the moderate risk line is increasing. I guess, would you talk that up to a function of maybe management's attention on getting that high-risk number down, so maybe a little bit of

slippage in the rest of the supply base? And are there concerns that these moderate risks become future high risks that they kind of get at these levels?

Just wondering how you think about focusing attention on getting that high-risk number down, with a little bit of slippage in the rest of the supply base? And maybe are there concerns that these moderate risks become future high risks if they kind of stay at these levels? Just wondering how you think about both those lines converging on a downward slope.

Paul Soubry^ I think if you looked at our chart, it's like a 9-block matrix that shows high risk and high impact. Basically, the ones that got into the highest end of that the top right of that chart, so highest risk, highest impact, some of them have gotten healthier and are moving down the chain from high risk to medium and ultimately, hopefully, we'll get in to low risk.

There is still, as I mentioned in some of my comments, there is still tremendous uncertainty around anything with a microprocessor and frustrations around confidence in supply that has electric components associated with it. The other -- a lot of the other parts that we were struggled with earlier this year and some maybe late last year have kind of worked their way out.

One of the problems we have unique to our business because of the bespoke nature of our products is that we don't have a defined supply chain for every bus. There's a lot of unique customization or unique product or elements that are put on those buses. And so something that could be green today could be yellow tomorrow or red overnight. We've always had that problem. We've always had that challenge to work our way with.

If David White and his supply team was in the room, he'd say we're in a much better position today than we were 3 months or 6 months ago. We still have issues with certain parts. We are still working at 2 to 3, maybe sometimes 4 levels down in the supply chain compared to where we used to be working. We are now looking at different strategies for different parts. And so it'll be very simplistic. But rather than just 6 or 7 days of inventory across the board, maybe there's certain parts that we only need 4 days of inventory and certain parts that will hold 15 or 20 days of inventory.

So all those things continue to be fluid, but the bespoke nature of our product will always have that level of complexity. You can read a million articles or talk to a lot of people about microprocessor supply. We've just seen the United States government make a very significant investment or plan to invest in domestic supply. But that whole world is not going to change overnight. We still have issues, and we'll continue to manage our way out through it.

I think what Chris and David have done with the whole issue with our VMM modules, the build and hold, the alternate or the next-generation module development is the kind of things we're going to have to continue going forward to make sure that we have as much flexibility as possible. We've just gone through a deep review of all of our supply base

and had a independent adviser do a really good review that says where we are able to dual source, we've done that effectively, where we are bespoke nature or batch buy or unique buy,. But we are still going to be beholden to the health of the overall supply chain.

So a lot of words there, but we're really confident, knock on wood, that we can execute through this this year. And as you just talked to Pipasu and Brian and Stephen about the ramp-up going into next year, we're not 100% of the woods, but we are much more comfortable with our ability to execute.

The other issue with execution is people. The slowdown in some areas of the economy that made it difficult to hire people in certain places where we operate, is now helping us a little bit with retention or attraction of new people. And what we've done throughout the last year is adjusted many of our locations, pay levels, compensation levels to make sure that we are market competitive and can attract those people. So our 2 biggest concerns were, do we have the parts, and will we have the people of a recovery. We've come a long, long way.

Kevin Chiang^ Maybe last one for me and maybe along the same lines, around kind of how you look at your supply chain. We are seeing a lot more OEMs as part of the broader EV strategy look to vertically integrate. And, I think this week alone, we saw Nikola look to acquire Romeo is obviously something we hear from a lot of the passenger vehicle OEMs. Is that something you think you'll need to pursue eventually? Do you feel that you'll be competitively disadvantaged versus other OEMs? If they're vertically integrated with the battery supply and you're not?

Paul Soubry^ It's a really good question, and it's a heavy, heavy issue that gets reviewed on a regular basis in our business. Just some context around the Nikola acquisition of Romeo. Romeo is a battery packager, right? The cells come from somewhere else, whether it's Samsung or LG Chem or whoever, and they package the cells.

In some cases, the packager will make the battery management software, in some cases, it's a third party in some cases, it's the OEM. As we've been saying probably for 4 or 5 years now, as we've got more and more zero-emission buses in our business and not only battery-electric but also fuel cell-electric.

We've chosen at this stage of our life cycle, for those kinds of components, to be smart buyers, not to spend hundreds of millions of dollars to get into the packaging of battery cells in the batteries. There may come a time where we want to move down that path. It's still very fluid. Supply chain of the sales continues to get healthier. We have in the last year dual-sourced now, and we expect delivery of battery modules from a second source starting in the fourth quarter this year.

At this stage of our lives, we think the best thing for us given the visible feature of our business continues to be smart buyers and the ability to adapt and move quickly without having to make $100 million investments. All that to say, could we move down that path

in the future? Maybe. Today, we buy packaged cells or modules, and we contract the battery management software. You may see us move in that case in the future or you may see us partner in a different way in the future, but dual sourcing and flexible buying today is the way we want to proceed with this.

Operator^ We have a question from Maggie MacDougall with Stifel.

Maggie MacDougall^ My question this morning is around cost of goods sold, inflation or parts inflation versus pricing. What we've seen in a bunch of industries is that a lot of basic material cost inflation has sort of peaked in Q2. And is starting to roll over and companies implementing price increases following that trend may have some benefit. However, given parts supply shortages, I think it might be a bit skewed for you in terms of the time line.

So could you walk us through the proportion of your backlog that you're going to deliver into in the next, call it, 3 quarters that might be sort of playing a bit of catch-up on increased inflation in basic materials? And when you think that benefit of pricing increases that you've been able to accomplish starts to accrue through the revenue line?

Brian Dewsnup^ Yes, sure. As we mentioned during the call, we're in discussions right now with a number of our customers. And while we do look at the same charts in the same indices and we see some of the commodities starting to roll over and come down, we're not experiencing that in our cost base right now. And so our current situation is kind of ongoing discussions with a number of our customers about price adjustments, as we see our costs where they are as we look forward to kind of 2023.

I think Stephen mentioned earlier on the call that things that we did in 2022 included kind of the economics of 2022. And so we expect that our pricing and our costing will be where we would like it to be in 2023. And if we get any sort of production through kind of economics or these commodities are starting to go down, that will just add to the margins in that time frame. But we feel very good about the contracts that sit out in that time frame and what we did in the last number of months with regards to the kind of economics and where we sit today.

Paul Soubry^ Maggie, it's Paul. So just a little bit of color, and we'll put an asterisks on my numbers and take them directional, not exact. When we head through the rest of this year, almost everything that we're going to build and deliver by the end of this year, we know the price, and we know the inflated costs that came through. And yes, we still get inflationary requests by our suppliers and so forth. But as Brian said, we are working with our customers to offset that stuff.

As we head into 2023, approximately 20% to 30% of what we build will have been bid in a previous year, previous to now where we may have inflation that's not reflected in the price. Everything that we bid for the last 3 or 4 months, and everything we'll bid throughout the rest of this year, is now reflecting the current inflated cost base. So if costs go down, we have an opportunity for some potential margin enhancements or mitigation.

Any contract that does have PPI indices. So when we are in a multiyear contract as we move to 2023, we will apply the indices at that time, which are now also at inflated levels of 10%, 12%, 13% depending on the indices.

So our forecast, which is today at early stages relative to 2023, will not have the same kind of bid previously hyperinflation on the cost and therefore, exposure. As I said before, maybe 20% 30% of the stuff we're going to build next year has that kind of price at a certain level with an inflated cost base. The rest of it, we are very encouraged that the margins will recover to normal, if not slightly better levels going forward.

Maggie MacDougall^ One more question. You've had to flex your manufacturing sort of throughput up and down quite a bit, since the beginning of 2020, with closures and idled facilities and all of that kind of stuff. And I imagine it's been difficult to manage from a workforce perspective. Can you give us some insight into how you're dealing with your employees who I'm sure are highly valued and communicating with them around now ramping back up?

Paul Soubry^ Great question. So yes, March 2020, we did the shutdown, we extended it, starts, stops, slow, speed up, all that other stuff. We got to the end of 2021 and then the supply chain really started to hurt us. We have done a couple of things. We have worked very progressively with our union partners, where the facilities are unionized on schedules. In some cases, moving from 5-day work week to 4-day work weeks and, in some cases, laying people off, calling them back as we started to return to increased operating levels.

Chris [Stoddart] and Brian [Dewsnup] and Janice Harper, Executive Vice President, People & Culture, have gone through and done benchmarking of wage rates in every one of our locations. And so while we, like everybody else, had an element of the great resignation or an element of turnover where somebody in the last couple of years could get a job down the street higher, we now believe that we're at or better than market rate in terms of pay for all of our facilities, which has done a lot for retention and morale in the last little while. Our turnover rates are getting into the comfortable neighborhood. We will be adding more people to our facilities as we grow through the fourth quarter of this year.

And, as Stephen alluded to earlier, getting up to kind of the return to the new run rates in the first half of next year. And so by adjusting those wage rates, I think we're going to be in a good place of hiring people with a certain skill base that we want to come into our businesses. Knock on wood, we haven't had maybe the same that other businesses have had on some of the professional turnover. Yes, we've lost some engineers. Yes, we've lost some supply people and so forth. We really haven't lost any salespeople or very few of the service infrastructure, which is so critical to our customers.

We're just starting another cycle of employee satisfaction surveys. At this point, nothing tells us that we're wildly out of sync with what we need to do to be successful going

forward. And, quite honestly, I'm tremendously grateful for the loyalty and commitment of our leadership team, which we've lost very few people to.

Maggie MacDougall^ Okay. Well, Thanks very much Paul, it's nice to hear your voice on the call. I'm glad to hear that you're feeling much better.

Operator^ And that was our last queue. I will turn it back to Stephen King for any additional questions.

Stephen King^ Yes. So thanks, Carmen. We had a couple of questions coming in through the webcast. So our first one is from Mark Neville at Scotiabank, who I know was trying to join via the phone, but had some technical difficulties.

You previously said you expected to receive the required control modules in August. And now that August is here, what are you hearing from your supplier? Have you received any in advance? And can you also elaborate on the alternative module of the alternative chip in the event there are further delays from the main supplier, could this alternative make up the gap?

Paul Soubry^ Go ahead, Brian.

Brian Dewsnup^ Sure. Yes. So as we talked a little bit earlier, our plan was always August. We're on that plan. Obviously, as we get closer to the plan, our confidence improves in that. I also mentioned that we've been active in the broker market to supplement that plan as well. So we're a couple of weeks away, and we feel very good about that and feel like we'll be able to begin working off the inventory and flush that backlog.

With regards to the alternate module design, we commissioned our first bus with that design a couple of weeks ago and it's still going through testing that everything is positive there. So we will have a second source for that. And the componentry around that looks to be ample as well. And so we'll now have 2 versions of our modules that we're able to use and feel very good about that supply over the second half of the year and our ability to execute on the order book for the rest of 2022.

Paul Soubry^ Mark, it's Paul. Just a little kind of color or comment on that, too. It’s one thing to get the modules. And as Brian, I think, alluded earlier, 4-plus hours or so to put them in there. It's not like we could put a bus in the FedEx box and ship it overnight. So delivering 200 or 300 excess buses over a couple of months or whatever it works out to be is not trivial. And part of the reason also alluded to delivery or rev rec potentially bleeding over to 2023, isn't as much about putting the modules in it but getting them to our customers' locations and accepted by customers. And that's why we've been a little bit conservative.

David's supply team has done an incredible job of working with the broker market. And the reason I say incredible and keep talking about it, we're dealing with suppliers of stuff

that we've never dealt with before. In a 6-month period, building a relationship with the actual microprocessor suppliers, the distribution network of that and then the brokers surrounding that has really been a enormous effort. So that extra supply that we have been able to secure, albeit at an inflated price. We're treating today as not additive to our business, but insurance to make sure we can deliver to the schedule that we've put forth to the banks and that we've negotiated with our customers.

So as Brian said, we're on that plan that we highlighted in May, and we're on schedule, and we're committed to try and deliver exactly as we had outlined at this point. As I say today, coming back, there is nothing that makes us feel that we can't deliver to that schedule.

Stephen King^ Okay. And our final online question comes from Julia-Simone Rutgers.

You mentioned that there's federal state municipal funding the big drivers of North American transit demand. But noted that there were no grants received like CEWS or other wage subsidy programs in 2022. Is NFI expecting to receive any grants from either U.S. or Canada going forward? The second part of the question, following the TTC commitments and the TTC report, how does NFI view the Canadian market going forward? And I know there have been some big announcements on grants and other cities. So Paul you can comment.

Paul Soubry^ Yes. So the unique wage subsidy programs of, I think that's called the furlough scheme in the U.K. or the Canadian Emergency Wage Subsidy in Canada, we are no longer eligible for any of that. So we have nothing planned from a wage subsidy or grant or expected in 2022 or 2023 and beyond. So as far as we believe that ship has sailed.

As far as the Canadian market, we actually started to see this probably in late 2020 and early 2021. where the federal government had done a couple of things. They have put money to work through the Canadian Infrastructure Bank to help with kind of changing the game on infrastructure investment, as well as a higher investment in zero-emission buses. And we've seen dedicated transit funding from the federal government. So the Canadian market actually has quite an encouraging outlook over the next little while in terms of the fleet rejuvenation in Canada with a serious commitment by the federal government on helping the provinces in the cities to make that happen.

Without letting too many cats out of the bag, to the point where today, where we buy, build cells in Canada and complete them in the transit states in the United States, Chris and his team is looking at scenarios of all Canadian builds going forward and those kinds of things to allow us to satisfy what we think to be a pretty encouraging Canadian market going forward.

Stephen King^ All right. And that is it for all of our questions. Thanks, everyone, for joining today's call. I just will mention one thing. One new addition to our Investor Relations program: we now have a supplementary financial package, which is basically a

large Excel file, which has all of our tables and all of our information from our MD&A and financial statements, which is also available on our website, should anyone need that for modeling and analysis of our financial results.

And with that, we'll end the call. Thanks, everybody. Have a great day.

Operator^ Thank you. Ladies and gentlemen, this concludes today's conference call. Thank you for participating, and you may now disconnect.