NFI Group Inc (2023 Q3 Results)

November 08, 2023

Corporate Speakers:
- Stephen King; NFI Group Inc.; Vice President, Strategy & Investor Relations
- Paul Soubry; NFI Group Inc.; President and Chief Executive Officer
- Pipasu Soni; NFI Group Inc.; Chief Financial Officer

Participants:
- Tamy Chen; BMO Capital Markets; Director, Equity Research Markets
- Chris Murray; ATB Capital Markets; Managing Director, Institutional Research, Diversified Industries
- Cameron Doerksen; National Bank Financial; Managing Director, Research – Transportation
- Krista Friesen; CIBC; Director, Institutional Equity Research

PRESENTATION

Operator^ Good day. And thank you for standing by. Welcome to the NFI 2023 Q3 Financial Results Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. I would now like to hand the conference over to your first speaker today, Stephen King, Vice President of Strategy and Investor Relations. Please go ahead.

Stephen King^ Thank you, Rozanne. Good morning, everyone. And welcome to NFI Group's Third Quarter 2023 Results Conference Call. This is Stephen King speaking. And joining me today are Paul Soubry, President and Chief Executive Officer; and Pipasu Soni, Chief Financial Officer. On today's call, we will provide an update on our third quarter 2023 results, the bid and order environment, and our outlook.

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 Investors section of our website. While we will be moving the slides via the webcast link, we will also call out the slide number as we go.

Starting on Slide 3, 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.

In addition, certain financial measures we reference today are not recognized earnings measures and do not have standardized meanings prescribed by International Financial Reporting Standards, or IFRS. We advise listeners to review the risk factors, financial definitions and non-IFRS measures statements found in our 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 reporting currency and all amounts referred to are in U.S. dollars, unless otherwise noted.

On Slide 4, 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.

Slides 5, 6 and 7 provide a brief overview of NFI. NFI is a Canadian headquartered global independent bus and motor coach solutions provider that is leading the evolution to zero-emission mobility. For those interested in a more in-depth introduction to our business, please visit our investor website.

Slide 8 provides the latest statistics showcasing NFI's leadership in zero-emission transportation, what we call the ***ZE***volution. Since 2015, NFI has delivered 3,361 EUs of ZEBs that have completed over 140 million electric service miles in more than 150 cities in six countries.

Demand for ZEBs continues to accelerate. Based on our data, we see over 50% of anticipated customer purchases in the next five years being electric vehicles, and 36% of our total backlog are now ZEBs. We continue to anticipate that at least 40% of our 2025 production will be zero-emission buses.

Given the backdrop of our products and solutions, sustainability and ESG, or environmental, social and governance, is of critical importance to NFI. Sustainability is a key component of our strategy, a core value, and influences how we make decisions. In 2023, we established a Sustainability Council made up of company leaders with direct oversight from our Board.

We also built ESG-related targets into our executive compensation program. To find out more, please visit the ESG section of our website where you'll find five years of our ESG reports and other related policies and charters. I'll now pass it over to Paul and Pipasu to walk us through the financial results.

Paul Soubry^ Thanks, Stephen, and good morning, everyone. I'll give you a bit of a highlight on the quarter, and Pipasu will give you the details. I'm beginning on Slide 10 with a summary. Demand remains very strong. The North American total public bid universe remains at a record high, and NFI saw a 114% increase in total orders year-over-year.

Funding for public transit is a major driver for this increase, but private markets have also seen increases, with MCI orders up 47% year-over-year, Alexander Dennis orders up

136%, and ARBOC orders up 93%. Third quarter consolidated results saw a 34% increase in new vehicle deliveries, a 58% increase in overall revenue, and 184% increase in Adjusted EBITDA.

Our aftermarket segment continued to deliver another strong quarter of outperformance with revenue up 21% year-over-year and with record quarterly Adjusted EBITDA. Results were primarily driven by increased sales in North America, favorable product mix, and management of our freight cost and logistics.

NFI's backlog remained strong at USD$6.6 billion, or nearly 10,000 equivalent units, with the average selling price for vehicles in our backlog increasing by over 20% year-over-year. This reflects a higher proportion of zero-emission vehicles and the pricing actions we have taken to reflect the impact of inflation.

We also ended the third quarter with over 1,800 equivalent units in bid award pending, which should position us very strong for another very strong quarter of backlog growth in the fourth quarter. Quarter-end net working capital remained elevated, however, at $462 million, primarily due to higher accounts receivable and inventory balances. Work-in-process inventory declined from the second quarter as we completed buses missing components and shipped those buses to customers.

Countering this reduction, we saw finished goods increase, which is typical for our business as we head into a busy fourth quarter. We also had certain buses that were not completely ready for customer delivery. Raw materials also increased as production ramps up, and we consciously chose to carry additional inventory to mitigate against potential parts shortfalls as the supply chain recovers.

As we move into 2024, we anticipate lower overall working capital balances and improved working capital days as we reduce work-in-process and work with our customers on final bus acceptance. On Slide 11, it highlights our overall supplier performance.

Supplier risk ratings continue to show improvement, although certain components remain challenged, including items in this quarter like high-voltage cables. As many of our suppliers are also increasing production to meet higher demand, we are keeping them on a moderate risk rating to ensure that we work closely with them and monitor their performance as we ramp up our own production levels. Slide 12 shows that we continue to increase new vehicle production rates, with our third quarter line entry rates up 10% from the second quarter.

This increase came from the addition of over 240 new direct and indirect team members, primarily in North America. We will continue to ramp up production throughout the rest of 2023 and into 2024 using a phased approach, matching consistent supply with labour availability. Production ramp-ups take time in our business, as we need to hire and train new team members.

We're also ensuring customers can handle delivery and inspection processes that are required to finalize performance on a contract. By 2025, we expect line entries to be back around the 1,500 units a quarter range, approaching 2019 levels, driving deliveries of approximately 6,000 equivalent units in 2025. Pipasu will now walk you through the highlights of the third quarter financial results. After that, I'll provide you some insights into our outlook.

Pipasu Soni^ Thanks, Paul. Picking up on Slide 13, our multiyear backlog remains strong at 9,556 units, split almost equally between firm and option orders. We have sold out all 2023 production slots and have sold a significantly higher percentage of 2024 slots than where we would typically be at this time of year, a testament to market demand, our backlog, competitive dynamics, and the strength of our product offering.

Heavy-duty transit bus deliveries were up by 34% year-over-year, and coach deliveries were up 9%. Notably, low floor cutaway and medium-duty deliveries were very strong, up 129%.

Slide 14 shows gross margins by quarter from 2019 through the third quarter of 2023. Manufacturing margins were relatively stable with the previous quarter, and, although still low, are now positive. We anticipate the positive margin improvement trend will continue as we ramp up operations and move beyond legacy inflation impacted contracts. Aftermarket continued to deliver very strong margin performance.

On Slide 15, we provide additional key financial indicators. Adjusted EBITDA met expectations at $11.2 million, a significant increase from this time last year. Free cash flow, while still negative, primarily due to higher interest expenses, improved by 23% year-over-year. Liquidity ended at $170 million, up significantly from $82 million as of the end of the second quarter of 2023, but down from $471 million year-over-year.

The changes primarily come from the completion of NFI's comprehensive refinancing plan in August 2023. Through the plan's equity and debt issuances, we generated $444 million of gross proceeds, but available balances under our senior and unsecured credit facilities were lowered by $275 million, impacting total available capacity. For the remainder of 2023 and into fiscal 2024, we expect a slightly longer cash collection cycle due to the significant increases in ZEBs and resulting time required for customers, final inspection, and acceptance once on their properties.

On Slide 16, we outlined the impact to our net loss and Adjusted net loss. Our net loss for the quarter was essentially flat with 2022 Q3, improving by 1%. Our improvements in vehicle deliveries, revenue, and Adjusted EBITDA were offset by higher interest and financing costs. In addition, we had fair market value losses related to interest rate swaps and the cash conversion option of our convertible debentures plus a gain from debt modification related to our refinancing plan. I will now turn the call back to Paul.

Paul Soubry^ Thanks, Pipasu. On Slide 18, we provide a summary of some of our key demand metrics. As previously mentioned, our North American public bid universe is at record levels, which includes RFPs received, bids that have been submitted to customers in response to an RFP, and a 5-year outlook of demand based on customers' fleet replacement plans.

Total active bids of over 10,300 equivalent units included 8,770 units and bids submitted, up 21% year-over-year, and another 1,591 equivalent units of bids in process. We anticipate these bids will lead to significant new awards, and, when combined with our 5-year customer outlook, we maintain our view that vehicle demand will continue to remain high going forward.

U.S.-based public transit agencies also continue to use purchasing schedules, an alternative to the traditional unique customer procurement process. This is alternate method to acquire buses using federal funds and can help speed up the selection process. NFI has now been named on over 40 of these purchasing schedules, generating awards of more than 1,130 equivalent units since 2018. On Slide 19, we highlight third quarter order and delivery activity. We received new orders of 969 equivalent units in the third quarter, which is typically a slower period for us due to the timing of transit agencies approval processes.

We also had another 1,834 equivalent units in bids award pending, where we have received notification of award from the customer, but formal procurement or purchasing documentation has not yet been finalized. This positions us for backlog growth in the fourth quarter of 2023. New orders helped drive our book-to-bill ratio above 100% for the third straight LTM period.

And we show on Slide 20, we expect this will continue in 2024 as we benefit from strong demand and healthy win rates. Our option conversion rates on an LTM basis remained low, but this is expected to be a temporary issue as we've seen numerous older internal combustion engine and legacy EV orders expire, being replaced by new zero-emission orders, and use of state schedules.

We anticipate conversion rates will start to show improvement in the last quarter of 2023 and as we move into 2024. On Slide 21, we detailed some of the new developments in the North America over the past few months. In October, we announced a battery pack supply agreement with American Battery Solutions, enhancing the resilience of our battery supply chain with an effective dual source battery strategy.

New Flyer's redesigned 60-foot Xcelsior CHARGE NG™ now includes additional battery strengths, increasing the range of the bus by about 30%.

Alexander Dennis followed its global strategy to partner with new contract manufacturers in expansion markets and appointed Nevada-based Big Rig Manufacturing as its North American build partner for the Enviro500 double-deck bus. Production starts in the first half of 2024.

And, finally, NFI's U.S. subsidiaries are now qualified manufacturer for the commercial clean vehicle credit program, which means customers can receive up to a USD$40,000 in tax credits per vehicle ordered. Last week, following years of design and development and testing, Alexander Dennis launched its next-generation battery electric buses for the U.K. and Ireland. On Slide 22, we outline some of the details.

The new Enviro100EV and the Enviro400EV double deck buses have been fully redesigned in-house in coordination with leading supply partners. I was in the UK for the launch event last week, and I can say that the new Enviro100EV minibus is a game changer. It combines big bus feel in engineering with the capabilities required for shuttle and transit applications. This unique product has the potential for a global offering by NFI.

On Slide 24, we provide a quick summary, as we always do, of the record government funding for each of our major markets, which continues to help drive zero-emission demand.

On Slide 25, we outlined some of the recent funding news. We had our strongest ever showing for the FTA Low-No Buses and Bus Facility grants as a named partner on more than $207 million in specific customer grants. Units identified for these grants do not immediately hit our backlog, but will lead to future orders in 2024 and beyond.

Alexander Dennis recently hosted the UK government for the announcement of the new GBP 129 million funding program called ZEBRA 2, which is expected to support procurements of zero-emission buses in 2023 to 2024 and 2024 to 2025 fiscal years. Turning to Slide 26, we show our updated guidance for 2023. We also reaffirmed our guidance for 2024 and for our 2025 targets.

Based on NFI's year-to-date performance and expected second half results, we've increased the lower end of our 2023 guidance ranges for revenue, and we increased both the lower and higher end of our Adjusted EBITDA guidance range again for '23.

We now anticipate full year 2023 Adjusted EBITDA to be between $45 million and $65 million, followed by continued significant recovery to $250 million to $300 million in 2024, and a target approximately $400 million for 2025.

The multiyear growth in our financial projections is driven by a combination of volume recovery, production efficiencies, improved product pricing, and an increased higher margin of zero-emission buses. We also anticipate we'll move beyond legacy inflation impacted contracts, with approximately 5% of our 2024 first half deliveries being legacy contracts with challenged margins.

We have seen signs of commodities and material costs easing during the first three quarters of this year and anticipate newer contracts in our backlog now reflect appropriate inflation-adjusted costing and pricing and with updated and more effective terms and conditions for NFI. Within the aftermarket, we expect continued revenue growth and strong margin contribution through the fourth quarter in 2023.

However, Adjusted EBITDA margin percentages may not continue at these elevated levels that we are experiencing today. Based on our guidance and working capital expectations, we do not anticipate significant debt repayments in the fourth quarter of this year. We are continuing to work on prepayment and deposit structures with our customers while also advancing efforts to lower our work-in-process inventory balances and enhance vehicle acceptance timing.

Based on delivery timing and cash flow conversion cycle, these efforts are not expected to have a material impact on cash flows until we move into the first half of 2024.

We've maintained our return on invested capital target of greater than 12% for 2025 with potential for outperformance on the metric as we delever our balance sheet and continue to improve in our working capital investments. We continue to work on return on invested capital expectations to ensure they appropriately reflect the changes to our capital structure following the completion of our successful refinancing plan earlier this year.

One of the underlying factors in our financial expectations is the increase in zero-emission bus sales mix. On Slide 27, we show that zero-emission bus deliveries have increased rapidly, going from 8% of our total volume in 2020, to 23% in the third quarter of this year. We expect further growth here in that zero emissions will be more than 40% of our deliveries in 2025 and could be potentially up to 50% of our total deliveries. Zero-emission buses as a percentage of our backlog have also been growing quickly, doubling in size from 2021 to 2022, and remaining stable at a record 36% in 2023, Q2.

Slide 28 shows the average price of each unit in our total backlog has dramatically increased both for heavy-duty buses in the dark blue line and motor coaches in the light blue line since the start of the COVID-19 pandemic in 2020, which reflects a combination of higher zero-emission bus orders, inflation-adjusted pricing and improved margins in our new contracts.

On Slide 29, we summarize our investment thesis. The actual results for the first three quarters of 2023, combined with our projections for the remainder of the year, demonstrate recovery is now underway. Completion of the refinancing plan, which included both debt and equity, was a major step for NFI and a strong demonstration of confidence by existing and new investors and our creditors in our business the recovery path and our future.

Our operations, while improving, are still not back to pre-pandemic performance levels or efficiency levels, and there's still work to be done to achieve higher production and delivery performance, but we are on a path and have a detailed plan to achieve these targets. Across the entire business, we are laser focused on cash management and improving operational performance.

We anticipate that we'll be able to reduce our overall working capital balances as we decrease work-in-process and move vehicles through to final acceptance, but we continue to anticipate some investments in inventory and accounts receivable as we increase production rates and the quantity of zero-emission buses that we build in 2024.

Our goal is to ensure working capital levels achieve a more typical pre-pandemic profile. We are confident about the path we're on, and the road that is in front of us. Andm as always, we're proud of our history and excited about NFI's future as a market leader.

I do want to bring to your attention the work that's being done in our industry.

The largest transit agency or transportation agency is called APTA, the American Public Transit Association. APTA recently launched a task force to look at the health and performance of the US, and, quite frankly, the North American OEM bus manufacturing sector and supply chain. This task force is co-chaired by the CEO of Chicago Transit Authority and the New York Transit Authority and has the full support of the FTA, the funding champion behind public transit.

We're very encouraged that this task force will help our customers and our industry deal with everything from milestone payments, and cash flow matching the investment in zero-emission bus manufacturing, but also things like terms and conditions and standardization going forward. We'll continue to update you on the task force as its work evolves over the next quarter. We will now open the line for analyst questions. Rozanne, please provide instructions to our callers. Thank you.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) Our first question comes from the line of Tamy Chen of BMO Capital Markets.

Tamy Chen^ First, I wanted to ask about the manufacturing segment. Your margin was flat quarter-over-quarter. Can you talk a bit about the moving pieces in there? What's still weighing on results? Because I believe, as we have continued through this year, the mix of those legacy inflation-impacted contracts should be representing a smaller and smaller portion of your mix. I would have thought there have been some sequential improvement in the margin, but we didn't see that yet. Can you just talk about the moving pieces in the quarter?

Paul Soubry^ Well, thanks, Tamy. There are two issues there. The first is that the vast majority of what we're building and delivering are still what we call legacy contracts where pricing was dramatically impacted either by hyperinflation or by rapid changes to foreign exchange rates, specifically on Canadian customer contracts. So that is continuing to be prominent in our deliveries. You'll see it again to a certain extent in our Q4 results.

The second issue is, as we work buses through the system. When. The labour to finish buses that are off-line and finish them or buses that are in customer acceptance continues to be a very significant inefficiency.

Our labour efficiency in the production of our buses continues to be in the 60% and 70% range where it should be in the high 80s percent range. It will take time as we finish off-line work, and it didn't surprise us what that margin or mix looked like. The other thing is you'll see us in Q4 start to really move some of that excess work-in-process through the system.

And, of course, every quarter has different elements of staff holidays or plant shutdowns and so forth, which impacts primarily in the third quarter of our company. So, you won't see that change and really and start to see of any materiality until the first quarter of next year.

Tamy Chen^ Okay. Got it. And, on the supply chain, you went through that chart of the number of at-risk suppliers, and that's come down in the quarter, which is encouraging. But I noted in other parts of the press release, as an example, there seems to be some cautionary language on the cadence of near-term margins. I think you also noted supply performance has been impacted by the fact that you've been increasing your line entries.

So, could you just bring that all together? It just felt a little bit conflicting. Overall, the supply chain situation, would you say that is improving? Or, we're still kind of like one step forward, then still one step back?

Paul Soubry^ Tamy, it's a great observation. On slide 11, it shows that the number of suppliers that are really challenging our business, whether they're high risk or medium risk has dramatically come down. We've done a number of things to try and mitigate. If you walk into our factory, you'd see more days of inventory online to mitigate risk of supplier performance. As you know, they're very complex vehicles. We continue to work with certain suppliers as they recover their business post-pandemic and supply chain challenges.

In some of the cases, it's not that our suppliers don't have the parts to build a product in time. They, too, are struggling with the recovery of their business and the hiring and training of people in that. So, they're dramatically regrouping their businesses. We continue to see isolated issues. For example, in the quarter, we call out high-voltage cables.

The dramatic increase in North America of equipment that requires high-voltage cables, whether it be commercial product or military product, continues to add certain pinch points in that supply chain. And unless you have all the parts, you still have labour inefficiencies, and you still have higher work-in-process. So, look, we're thrilled to see that chart drop down to manageable levels. David White and the supply team here have people now that are out physically at our customers' locations. We've revamped our supplier development team and restarted a lot of that work to get those people healthy.

But, remember, they're highly customized vehicles. And, by definition, you're going to have situations where not all the parts are on there. So, we're really feeling good about where we are, but it's not a light switch. It takes time. And, remember, in a parts world, if we have an order, and we don't have all the parts, we can still ship the vast majority of them.

In a bus world, if you don't have a high-voltage cable, or you don't have a window, or you don't have a seat, you can't ship the vehicle. And that's just the ramping up of that supply chain. The improvement of our business is better and better and better, and we expect to continue to see it being better in 2024.

We are raising our production rates to meet what is a tremendous backlog, but we're very careful not to raise it too fast. We need to have enough trained and skilled people at our facility or that our supplier community can't keep up. The worst thing we can do is create more off-line work-in-process that we can't deliver to customers, that sucks up working capital. So, you'll continue to see us through the fourth quarter being cautious at the increased rate, but also laser-focused on managing supply chain to get buses out of here to our customers and then accepted.

Operator^ Our next question comes from the line of Chris Murray of ATB Capital Markets.

Chris Murray^ Thinking a little bit longer term, Paul. As we go into 2024 and 2025, one of the questions that I get a lot is margins getting back to normal. And there's been a bit of discussion around the average selling price being higher. But I just wanted to get your opinion on transit and where do you think you can get back to. Call it, that high single digit, low teens margin profile.

And I don't know if you want to think about it in terms of EBITDA per unit or a percentage margin because I know there's different ways that the pricing flows into profitability. But, how do we think about where the target or the end ranges for the manufacturing business?

Paul Soubry^ Well, thanks, Chris. It's a great question. This is part of the reason that we gave kind of multiyear guidance. And of course, with a more expensive zero-emission vehicle and an improved EBITDA per unit, you still have challenges with the percent margins, which is why I think we've talked many times we don't get too fussed about percent margin per unit. We spend a lot of time focused on dollar per unit that gets through the facility.

There is no question that average selling price has gone up for a couple of issues. One, we have tried to embed all of the inflation-impacted cost into the business. Two, we have done our own little hedging or protecting, if you will, of any uncertain price increases. Three, we still have challenged efficiencies in our business of getting work through. So, that's going to help margins get better and better as we get up into the 80s [%] of labour efficiency.

And the last thing, quite frankly, is we have increased the margins on our product. This goes back to things like this task force at APTA where what the industry wants is healthy suppliers. We went through a year with one supplier pulling out of the U.S. One supplier in Chapter 1. And, so, full health of our business doesn't happen overnight.

You'll start to see that through 2024 and into 2026. We believe we'll get up to high single digits in manufacturing where we were before and a very strong margin percent performance in the aftermarket business.

Chris Murray^ Okay. And then the other question I had for you, and maybe this ties into some of this discussion that APTA is having, but just give me thoughts on the coach business and how we should be thinking about what's out there for orders in 2024.

I know your bid pipeline focuses more on transit, but I'm just kind of curious about how coach is behaving, not only in the private market, but in the public market because, typically, public markets have been I think about 20% of the marketplace, but it's been a little lumpy as well over the last few years. So just thoughts on how we should be thinking about that over the next couple of years would be great.

Paul Soubry^ Well, that's a great question, Chris. Historically, when we were able to acquire MCI in, I think it was, 2015, we always thought of MCI as roughly about a 60% private business, roughly 40% public. And the mix changes every year based on purchasing cycles and so forth. There are a lot of RFPs that are in the system today for New York, New Jersey, Houston; others that really are starting to relook at rejuvenating the motor coach fleets. The private market is actually showing really, really positive recovery.

It's better than I thought it would be at this point in the recovery cycle. Pricing is relatively healthy in that market. Margins are good. We're spending time, effort, and money at optimizing, for example, the Winnipeg production facility. We're now on a full common line as opposed to two different production lines. And, so, we're really pleased with the demand in the private market for motor coaches of recovery, and we're pleased with the appropriate pricing in the marketplace.

One of the things that plagued us in the past was the trade-in market. And we, as an industry, kind of kid ourselves on what the ultimate profitability of that segment is because we can give them higher or lower trade-in values. But, in fact, the used market has retained value. The other dynamic: as healthy as it has been in recovery, we're continuing to be very cautious in watching the market as interest rates go up, and watching what customers do on fleet rejuvenation in the private market. We haven't seen a slowdown in demand since it's recovered, but there's a risk there.

So, we're just managing the MCI capacity. The performance of the business of MCI is better at this time than I thought it would be, and there's even more to be had as we continue to optimize the production into that common line.

Operator^ Our next question comes from the line of Cameron Doerksen of National Bank Financial.

Cameron Doerksen^ I wanted to ask just about the working capital. You provided some color there on the next few quarters. Just wonder if you can delve into that a little bit more. If I read you correctly, it sounds like we're still going to be some investment in working capital in Q4 and maybe that starts to unwind a little bit in the first half of 2024. So maybe you can just sort of walk us through the pace of what we're going to see as far as the working capital investment or unwinding in the next few quarters?

Paul Soubry^ I'll start it off and then ask Pipasu to give a bit of color. We still have bloated work-in-process in our facility as we talked earlier about, Again, we get the parts for a bus that is built, and off-line there's still a lot of gymnastics to get that bus built, completed, tested and then through the customer inspection process. And the fact that there's more zero emission buses means that we've got more dollars tied up in work-in-process. We also have a bunch of buses that were delivered to customers through the pandemic cycle that we call Acceptance WIP.

Once we deliver the bus to the customer, we’ve got revenue recognition, but we don’t have acceptance from the customer, which then allows us to invoice and collect the receivables. We’ve been the benefactor of certain customers proceeding or pushing earlier some of their payment cycles.

But, until we get the back to normal, if you will, in acceptance WIP, we still have excess dollars tied up in there. The other factor that is really starting to show itself as we do more zero emissions is, on average, our customer contracts on acceptance takes something like 15 to 20 days for them to say, "Yes. I'll accept the bus. And yes, you can invoice me.”

The zero-emission buses are taking something like twice that number, almost 40 days in some cases, to get a customer who's now new to the zero-emission game to accept that bus. Some of it is their knowledge or skills and ability; some of it is their readiness on testing the vehicle from a charging infrastructure and so forth. So, we've got a couple of things at play. The burn down of excess work-in-process and the burn down of higher-than-normal acceptance WIP.

Also, as we are increasing our business volumes, the units we're putting to the factory are more expensive vehicles right now, which goes back to this task force of the U.S. government and APTA trying to figure out how to introduce things like standardized milestone payments or some ability to actually fund the working capital through the build cycle. So, we're not yet…it's not a light switch, which I said before. We need to get the buses off-line, finished, to the customers, and then we have to get through acceptance work-in-process. We don't see a lot of that unwind of cash. We'll start to see some of it.

We did in the third quarter We'll see more of it in the fourth quarter, and then we'll see it in 2024. But we do expect the working capital per dollar of sale to continue to be elevated as the mix changes. If we are successful through the APTA task force with making milestone payments standardized, that will fundamentally change the game in terms of our working capital profile. Pipasu, anything to add to that, any context of the quantum?

Pipasu Soni^ Number one, Paul nailed it, Cam. Just a couple of quick things. Our viewpoint is, to summarize what Paul said, brief unwind in Q1. We expect to have some more needs in Q2 because of the ZEB ramp-up.

And I think everything else Paul covered because, with the WIP burn down we've got, we're going to have more stuff in acceptance, which obviously will take some time to go through because it's a lot of the EVs. So, I think you've got it all nailed.

Cameron Doerksen^ Okay. No, that's helpful. And maybe a second question, just on, I guess, the U.S. transit market. Obviously, you've got kind of a government budget impasse there.

I'm wondering if there's any impact on the finalization of orders from U.S. transit agencies as a result of any issues around the continuing resolutions and things with the U.S. budget.

Paul Soubry^ Well, the benefit of having buses that are funded through the FTA is that the money that has been set aside or appropriated for orders we already have is locked in. It's not like they need new money to pay for buses that are on their order.

The good news is, at least, for our public transit business in North America next year, the slots are almost effectively all sold out with pre-appropriated money. So, we don't anticipate any impact on the demand that we have, the contracts we have, and the conversion of the options that we expect.

There could then be a slowdown in bids if there's a big loan government impasse; we don't see it. And customers continue to be confident that the money is there for the worth the buses they've already effectively contracted for. The parts dynamic is a different one. Parts businesses, as you may remember, Cam, is 100% funded by local money, not by federal money. So, we don't see a slowdown if there was a government path in any of our aftermarket businesses.

Operator^ (Operator Instructions) Our next question comes from the line of Krista Friesen of CIBC.

Krista Friesen^ I was wondering if I could just follow up on the supply chain question that Tamy was asking earlier. Have you seen, since the end of the quarter, any sort of impact from the UAW strike, as it impacted some of the smaller suppliers who maybe had to lay off some workers there. Just wondering if you saw any issues from that.

Paul Soubry^ It's a good question. We've had a lot of people asking about that. The supply chain for public transit is, let's call it, customized and niche, a very different supply chain from the mass automotive manufacturers.

So, we didn't see any impact of those strikes, nor did we anticipate they continue on forever for a longer period of time impacting our supply chain. We're still in recovery mode of that customized type supply chain, again, largely driven by North America, which not the same dynamic you have in the automotive world, which is more of a global supply chain.

And the other dynamic where we could have been exposed that we haven't yet and don't anticipate to be is our ARBOC business, which builds cutaway buses on GM or Ford chassis. We have a very strong pool, almost a year's worth, of chassis on our lot or in transit to us right now. So, we don't have an issue. We haven't seen an issue, don't anticipate an issue associated with those UAW strikes.

Longer term, we may see scenarios where some of those increased awards or agreements in those CBAs trickle into the broader U.S. manufacturing industry, ours included, which means potentially higher prices for things going forward. But, at this point in time, we don't expect any impact. And, keep in mind that labour as a percentage of the manufacturing of our product is somewhere in the 10% to 15% range. So, it will impact, but will not have an impact long term as labour rates go up.

Krista Friesen^ Okay, perfect. And, on the labour front, it sounds like you made good progress hiring 240 new members. How many more people are you looking to hire? And what's the timeline you're targeting there to ramp up to full employment?

Paul Soubry^ So we're well into the process of building the detailed annual operating plan for our business for next year. We have consciously hired more and continue to hire more people, expecting to continue to ramp up.

Remember that they're not just nonskilled labourers. The fact that we're doing way more zero-emission buses, the understanding and the skill set to be able to build that kind of a vehicle, is more than just a normal internal combustion engine. We've been successful at hiring. There are still a few pockets in the United States where it's very difficult to hire.

We're working with community colleges, high schools, traditional disadvantaged communities that we're trying to hire from. We've ramped up our resources in recruiting. We're bringing them in earlier to try and train them. We're good, I think, in terms of the labour that we need to finish the buses for the rest of the year. As we ramp up for next year, there's probably 300 to 400 people that we need to add to our overall business mix to deal with the ramp-up.

I also continue to caution people that we are inefficient today as we work down off-line WIP. And, therefore, as we get that offline WIP caused really by the pandemic supply chain dynamics back up, we effectively have capacity in our business today that we're paying to do off-line WIP work that can help with first-time build inside the business. So, it's not massive. We have a global workforce of about 8,000 now, and we need to add maybe 300 to 400 next year to deal with our ramp-ups.

Krista Friesen^ Okay. Perfect. And just one last one from me. Can you provide more details around the kind of cadence in line entries you're expecting from now through to 2025 when you expect to reach those pre pandemic levels?

Paul Soubry^ So every one of our business units has been increasing the line entry rates. We troughed probably, I would say, in the first or second quarter of this year, where we probably had the worst supply chain performance. We are increasing those line rates somewhere in the neighborhood of single digits in terms of the percentages increase at this point in time. As we've talked and tried to explain many times, it's not step-change ramp-up; it's gradual.

Going from x units to x plus 2 to x plus 3, plus 4, over weeks and months is our pace of ramp-up. We won't get to that 140 or 1,500 units a quarter, which is our pre-pandemic levels, really to the end of 2024, quite frankly, as we start into 2025. We get that gradual ramp-up across the entire business through the rest of this year into 2024, and you'll probably see us hitting those pre-pandemic run rate levels in the first quarter or first half of 2025.

Operator^ Thank you. I'm showing no further questions at this time. I would now like to turn it back to Stephen King for closing remarks.

Stephen King^ All right. Thanks, everyone, for joining us this morning and for your questions. As always, if any investor or anyone has any follow-up questions, please feel free to reach out and contact our Investor Relations department at any time. All of our materials are on our website, and we encourage folks to read our financial materials, our disclosure materials on our website, and on SEDAR. Thank you, and have a great day.

Operator^ Thank you for your participation in today's conference. This does conclude the program. You may now disconnect.