NFI Group Inc (NFI 2024 Q3 Financial Results Call)
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Corporate Speakers

- Stephen King; NFI Group Inc.; Vice President of Strategy & Investor Relations
- Paul Soubry; NFI Group Inc.; President and Chief Executive Officer
- Brian Dewsnup; NFI Group Inc.; Executive Vice President and Chief Financial Officer

Participants

- Chris Murray; ATB Capital Markets Inc.; Senior Analyst
- Krista Friesen; CIBC Capital Markets; Director Equity Research
- Daryl Young; Stifel; Equity Research Analyst
- Cameron Doerksen; National Bank Financial; Analyst

PRESENTATION

Operator^ Thank you for standing by. My name is Kate and I will be your conference operator today. At this time, I would like to welcome everyone to the NFI 2024 Q3 Financial Results Call. (Operator Instructions).

Thank you. I would now like to turn the call over to Stephen King. Thank you and please go ahead.

Stephen King^ Thank you, Kate. Good morning, everyone, and welcome to NFI Group's Third Quarter 2024 Results Conference Call.

Joining me today are Paul Soubry, President and Chief Executive Officer, and Brian Dewsnup, Executive Vice President and Chief Financial Officer.

On today's call, we will give an update on our quarterly results highlighting year-over-year improvement across numerous financial metrics, the strong demand environment for our products, and our record backlog. We'll also provide an update on the operating environment and our near and long-term outlook.

This call is being recorded and a replay will be made available shortly. We will be referring to a presentation that can be found in the investor section of our website. We will be moving the slides via the webcast link and we'll also call out the slide number as we go for participants on the phone.

Starting with Slide 2, we provide our cautionary or forward-looking statements. We note that certain financial measures referenced today are not recognized earnings measures and do not have standardized meanings prescribed by International Financial Reporting Standards, or IFRS. We advise listeners to our press releases and other public filings on CDAR for more details.

A reminder that NFI 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 3, we have included some key terms and definitions referred to in this presentation. Of note, zero-emission buses or ZEBs refers to vehicles that do not have internal combustion engines. Equivalent units or EUs is a term we use for both production slots and delivery statistics.

Slides 4 and 5 provide a brief overview of our company. More detailed information is available on our website.

In summary, NFI Group is a global independent bus and motor coach solution provider that is leading the evolution to zero emission mobility. We are a purpose-driven organization and exist to build vehicles that move the world's most precious cargo. We move people. We play a critical role in global transportation and every bus we put into service supports the journey to reduce global emissions.

I'm now on Slide 6, which provides NFI's latest zero-emission statistics. Since 2015, NFI has delivered over 4,300 EUs of ZEBs that have completed over 220 million electric service miles across 150 cities. Our infrastructure solutions team has installed over 540 electric bus chargers, totaling more than 87 megawatts of capacity since 2018.

I will now pass it over to Paul to provide an overview of NFI's results for the third quarter.

Paul Soubry
Thank you, Stephen, and good morning, everyone. Thanks for joining us today. I'm now on Slide 8, where we provide a summary of the third quarter.

Financial results reflected our continued recovery and growth with significant year-over-year improvement. We had a 375% increase in quarterly adjusted EBITDA, helping contribute to 161 million improvement on an LTM basis. Gross margin improved to 12.2%, representing the highest gross margin we've had since the first quarter of 2021.

On the demand front, we had new orders of 1,050 equivalent units in the quarter, up 8.2% from the previous year. With 7,585 equivalent units of new awards so far this year, 2024 is shaping up to be another record year for new orders for NFI.

As we expect additional large multi-year orders in the fourth quarter, we anticipate our $12 billion U.S. backlog will continue to grow. This is primarily driven by the North American public transit and coach operations, with a number of active bidders on many new RFPs has reduced substantially. In a number of recent cases, NFI was the sole bidder.

Our trailing 12-month book-to-bill ratio remained really strong at 115%, primarily driven by our increased order intake. And our option backlog conversion rate also showed continued recovery, now reaching 70% on an LTM basis.

NFI's aftermarket segment delivered yet another exceptional quarter, with $153 million in revenue and $34 million of adjusted EBITDA, up 7% and 8% year-over-year, respectively.

Now, as a result of the U.S. task force from APTA, supported by the FTA and the White House on healthy contracting, we continue to have success securing prepayments and embedding milestone payments and proper contracting terms in our bus contracts with customers. This is having a positive impact on our liquidity and cash flows.

However, working capital remains elevated due to an increase in zero-emission bus production, reflecting higher input costs, and the adverse impact disruption of a significant North American seat supplier that has non-performed to our schedule, which we'll discuss in a little bit more detail later in this call.

Slide 9 walks you through our third-quarter deliveries. We had our highest quarter ever of low-floor cutaway bus deliveries in Q3. Coach deliveries were also up, and transit deliveries reflect the impact of the seat supply disruption and operational efficiencies as we ramp up production and the impact of higher ZEB production.

In total, the seat supply disruption led to a loss of approximately 79 EUs of planned third-quarter deliveries. We also had lower production rates as we managed offline buses trying to -- bus finishing and the working capital.

We are focused on improving fourth-quarter result transit deliveries as we complete and ship contractually sold buses that were missing seats from inventory. Offsetting the decline in deliveries was an 11% increase in the average selling price of the heavy-duty transit bus, along with improved manufacturing gross margins.

Now on Slide 10, I'll walk you through the impacts of the seat supply disruption. I'll start with the overall supply chain health. The chart on the screen goes back to 2020 and reflects the deterioration of NFI supplier delivery performance starting in the second quarter of 2021.

Through the remainder of 2021 and 2022, numerous high- and medium-risk suppliers had a dramatic impact on NFI's performance. In 2023 and 2024, we made tremendous progress as we expanded our active supplier development and monitoring program. We only have two suppliers currently rated as high-risk, high-impact.

One is the United States-based seat supplier, who is now not meeting their delivery timelines, which has impacted NFI and our competitors and some of the broader rail and transit industries. This has caused disruption to our master production schedule and obviously impacted our planned deliveries.

On Slide 11, I'll provide a quick overview of the steps involved in North American public transit procurements and the manufacturing process to give you some context on the impact of this issue.

On a typical procurement, the customer issues a request for proposal with unique customized specification. We then work with the specific supplier and others to develop costing and pricing and estimated delivery timelines. After bidding and securing a contract, we determine where it fits into our master production schedule.

We then complete final engineering design typically 26 weeks prior to the bus for an order being started at our facility. Seat engineering is completed at this stage and based on the shop floor plan of the bus -- sorry, the planned layout of the bus. We also finalize the seat structural attachment points in the wall and floors that are specific to those seats and unique to every bus built.

Suppliers are given a lead time of up to 15 weeks prior to commencement of the first bus build to prepare for their delivery. We begin the manufacturing process with the steel frame, then the exterior fiberglass, the roof, followed by interior installations. This is where the seats are installed based on the pre-engineered design.

It is nearly impossible to switch an alternative supplier at this stage in the process given the engineering design and limited alternatives, plus the fact that there are very few Buy America compliant seat providers. Buses are inspected at our factory before they're shipped to customers where they go through another final inspection and then get put into service.

So moving to Slide 12, we highlight our strong response to this seat issue and its current impact. We and our direct competitors have sent dedicated oversight and production resources to the supplier to support their people and their build process. We were active in an intervention with the supplier where we pushed them to hire external operations consultants and to develop and execute on a recovery plan. They have also hired third party labor to increase their manufacturing output.

I will note that we are receiving some seating kits and shipping some affected buses, but we did not see an increase in the number of missing seats in October. It is difficult to predict the duration of this transformation and impact, although we expect it to continue for at least the remainder of 2024 and there is risk that it may move into 2025. During this time we are actively working with our customers to expedite advance payments for these essentially complete buses which will support our liquidity as we carry higher working balances in the short-term.

We have also actively engaged a successful European seat supplier who currently builds for MCI and Alexander Dennis to set up a Buy America compliant seating production in the first half of 2025. We expect this will take some of the pressure off this challenge supplier and the overall supply of seats that are Buy America compliant.

I'll now turn it over to Brian Dewsnup to discuss the results in more detail and back to give you an outlook shortly.

Brian Dewsnup
Thanks, Paul. Picking up on Slide 13, manufacturing gross margins for 2024 Q3 improved slightly over last year even with the lower deliveries we experienced. This is primarily driven by the fact that we completed our legacy inflation impacted contracts earlier this year. We continue to expect manufacturing margins will improve with significantly better pricing in our backlog, the increased contributions from ZEBs and as we execute on production efficiencies. The aftermarket gross margin percentage was up quarter over quarter to 29.6% but down slightly year over year reflecting unique sales mix in the quarter.

Slide 14 walks through year over year changes and adjusted EBITDA within our reporting segments. Manufacturing EBITDA was up by $31 million even with the lower deliveries reflecting the significant improvement in gross margins.

Our aftermarket segment continues to deliver healthy EBITDA growth driven by sales volume and improved gross margins. Corporate adjusted EBITDA improved due to the positive impacts of FX, contributions from our captive insurance business and lower incentive compensation approvals.

Turning to Slide 15, you can see the LTM adjusted EBITDA for manufacturing and aftermarket from 2020 to 2024. Both segments have seen strong improvements even with the impacts of seat supply disruption. Aftermarket adjusted EBITDA achieved a record $136 million on an LTM basis and manufacturing has seen strong recovery from the lows of 2022 and $180 million year over year improvement with further growth projected in 2025.

On Slide 16, the company experienced a net loss for the period of $15 million which was still a 62% improvement year over year. On an LTM basis we saw an improvement of 91%. We've also provided a chart on this page that reconciles net loss to adjusted net loss including normalization items that are detailed in our MD&A and press release.

On Slide 17, pre-cash flow was positive for the versus a negative $43 million in the third quarter of 2023. We did have another quarter of working capital investment reflecting the impacts of inventory growth. This was somewhat offset by increases in deferred revenues of $47 million showing continued progress on our new customer payment structures.

Slide 18 is inventory and production rates. In the quarter, seat disruption was the primary driver of inventory growth and lower line entries. We experienced a number of weeks of lower production as we managed working capital and focused on completing buses missing seats. In addition, we also had some production inefficiencies as we increased production of more complex ZEBs.

On Slide 19, we recap our total leverage ratio and covenants which resume in the third quarter. You can see the significant decline in our leverage ratio on the chart from over 14.1 times in 2023 to 5.19 times in 2024. And we expect to get back to our target leverage ratio range of 2 to 2.5 times by the end of 2025, well within our bank covenants which are shown on the chart.

During the quarter, we also advanced discussions with our banking partners and evaluating options for shifting debt balances into different instruments that may provide opportunities to both lower our total interest costs and increase overall liquidity. We will provide a further update on that front with our fourth quarter results.

Liquidity and cash management remain a key focus as we navigate through the seeding headwinds and continue our production ramp up. As Paul mentioned, we're actively securing additional customer prepayments and deposits. We've also secured improved payment terms from certain suppliers.

Finally, in October, we obtained a proactive temporary waiver from our banking partners that allows us to access the additional $50 million under our secured facilities should we need it. We did this out of an abundance of caution as we do expect that our current liquidity combined with the additional customer payments will be sufficient to fund operations.

I'll now turn the call back to Paul.

Paul Soubry
Thanks, Brian. At NFI, we're absolutely frustrated with the seed situation but extremely proud of the year of year improvement growth and performance of our business. We are poised for a strong continued recovery and growth in revenue, adjusted EBITDA, free cash flow and net earnings.

Over the next few slides, I'll walk through a couple of key factors underpinning these observations and growth. On Slide 22, we provide a summary of some of the key public demand metrics for North America. We ended the quarter with total active bids for public customers at 8,759 equivalent units, including 3,226 in bids that we've already submitted and another 5,500 bid of EUs that are bids that are actually in process, which has increased from the second quarter of 2024.

The black line on the chart overlays our awards versus the active bids. You can see the correlation between the bids in the light blue and the contract awards. We anticipate current bidding activity will help further grow our already record backlog.

Our five-year expected public bid forecast, which is compiled from published customers' fleet replacement plans, is up now to 20,690 EUs. This highlights a longer-term outlook driven by robust funding that we recap on Slide 22. Multi-billion-dollar investments have been made in the U.S., Canada, and the U.K. to support transition to low- and zero-emission fleets and to address congestion in urban centers.

The U.S. is working through the Transformational Infrastructure Investment and Jobs Act, or IIJA, that is in place until 2026, with spending that will go beyond 2026 as vehicles are manufactured and delivered.

In Canada, we've expanded their federal funding through a new $30 billion Canada Public Transit Fund. Canadian federal-level funding has been a significant driver of increased Canadian demand. The combination of existing Canadian backlog alongside active bids and positive outlook from our customers has helped us now launch our All-Canadian Transit Bus Build project.

This will increase our Canadian productive capacity and competitive starting late in 2025 before reaching full run rates at the end of 2026. By adding capacity in Canada for Canadian customers, it also frees up capacity for more U.S. customers that require Buy American production.

The recently elected Labour government in the U.K. is continuing to fund existing programs that support zero-emission bus purchases, which also focusing on placing more investment into the hands of regional decision makers across the U.K., with a desire to ensure funding dollars provide broader benefits for U.K. industry and the U.K. economy.

Turning to Slide 23, based on our year-to-date performance, the impacts from the seat supplier disruption, and our anticipated fourth quarter, we have had to slightly adjust our 2024 financial guidance. We now expect to generate adjusted EBITDA between $210 million to $240 million from the revenues of $3.1 to $3.3 billion, with 20 to 25% of those deliveries continuing to be zero-emissions.

While this is a decrease from our earlier guidance, it does represent $141 to $171 million year-over-year improvement in adjusted EBITDA. For our 2025 targets, we are actively completing our annual business plan for next year based on our typical process, but continue to see a strong path to delivering our targeted adjusted EBITDA of greater than $350 million for the year.

The improvement in 2025 will be driven by significant increase in deliveries, with zero emissions representing approximately 40% of our volumes, improved growth margins, strong continued aftermarket performance, and improved overhead absorption. We are assessing the impacts of seat disruption and the improved competitive environment in North American transit and other factors as we finalize this plan, and as Brian mentioned, we hope to provide or we will provide a detailed update after we close out 2024.

We have maintained our ROIC target for greater than 12% for 2025, with potential for outperformance of this metric as we see improvements in working capital invested, continued progress on customer milestone payments, and advancing the changes we want to make to our debt structure.

On Slide 24, we show our current expectations for strong fourth quarter, which is typically the busiest period due to the seasonality of our business. The range for Q4 impact reflects the impact of seat supply disruption, our planned shipping recovery of buses from inventory as seats are delivered, plus the potential timing of zero-emission deliveries in both North America and the UK.

Our margin profile continues to improve, with the graph on the right-hand side showing our gross margin profit per equivalent unit, which includes cutaway, medium duty, coach, and heavy duty for both North America and international. We had a strong positive trend here, which we will continue to see improving in 2025.

Turning to Slide 25, we highlight the increasing average sale price or ASP per EU in our total backlog, which helps support our ability to reaffirm this guidance. This amount has increased for both heavy duty buses in dark blue and motor coaches in light blue. Year over year, the average selling price of heavy-duty buses in our backlog was up by 17% and up by 62% since 2021.

The average selling price for coaches was up 14% and 27% over the same time periods. The average selling price increases were driven by a combination of higher percentage of zero-emission orders, inflation-adjusted pricing, significantly improved margins in our new contracts, reflecting the competitive environment we now see ourselves in today.

There are a few additional slides in our appendix that provide additional detail and metrics that further support our 2025 targets and our positive long-term outlook.

I'm now on Slide 26 and will provide a few closing comments and then open the call up to Q&A.

Our financial recovery continues to advance and we are capitalizing on record demand in a dramatically improved pricing environment for our products and services. We see significant growth in our financial metrics as we have the largest backlog in company history at $12 billion. This equates to almost three years of production.

We have already nearly sold off all of our North American public transit slots for next year and are now selling well into 2026. Our competitive positioning has improved in North America and we are working on several major bids that will further add confidence to our longer-term outlook with limited bidders competing.

We are also actioning strategic initiatives to further strengthen our North American team to ensure that they capitalize on our market-leading position and ensure supplier performance. Aftermarket is another continued bright spot for us, providing steady recurring revenue streams and a solid foundation for cash flow generation.

In the UK, competitive dynamics have increased, especially from foreign competitors, and we are actioning initiatives to continue to lower our cost-based response. We've launched a new line of zero-emission chassis in late 2023 and have received a very positive response from customers on both the styling and performance of these vehicles.

We remain the market leader in the UK and feel we can continue to grow, but need to see the improved winning performance of these new zero-emission platforms. While we tackle the headwinds on seat supply and production efficiency, we are confident we'll get through them and deliver on our backlog to provide strong future growth.

I'm grateful and very proud of our team. We're now backed over 9,000 strong who are working incredibly hard and remain committed to our customers and our shareholders. While our recovery is well underway, we do not anticipate the work ahead of us managing with risk in the challenging operating environment.

I look forward to continuing improved and positive progress in the last quarter of this year, where we anticipate continued year-over-year growth as we move into 2025.

With that, please open the line to our analysts' questions and provide instructions to our callers.

QUESTIONS AND ANSWERS

Operator (Operator Instructions) Your first question comes from the line of Chris Murray with ATB Capital Markets. Please go ahead.

Chris Murray
Yeah, thanks, guys. Good morning.

You know, I guess thinking about the seat problem and your revised guidance, if you look at what that implies for Q4, it's a pretty wide range, even if you think about where your number is going to be.

So, can you just maybe walk us through some of the puts and takes of kind of what gets you to bottom end of the range, what gets you to the top end of the range?

Paul Soubry
Sure. It's a good question, Chris. It's one of these unique dynamics where the supplier is spec'd by the customer. We don't really have leverage on the supplier. We do supplier monitoring. We do vendor development. We audit the supplier. Performance was deteriorated in the first part of this year. We were there. We were involved. We saw recovery.

And, of course, as of the end, as we worked through the end of the third quarter, their performance massively deteriorated. This is a company that was moving from an old, tired facility into a new one. They moved the assembly operations, and they got into real troubles when they started to move the fabrication capability. Then they lost control of their MRP system.

So, the number of units that were affected, as I think I said in my notes, that affected the Q3 delivery specifically was about 79 buses. At the same time, we had to continue to adjust our production rate because the last thing you want to do is line enter more vehicles where you know you're not going to have the seats. And, therefore, the inventory for the rest of the bus is on the way in.

So, as I said, at the end of the quarter, we had 79 that we'd expect to send -- to deliver. We also had a few of the units, the seats that were supposed to be delivered to Alexander Dennis' U.S. double-deck production that weren't delivered.

In addition to the 79 delay that we thought -- that we experienced, and, therefore, we couldn't ship a bus, we also had another -- or, sorry, as of today, we're at about 113 offline. So, not only did it get out of control, it got very deteriorated very, very quickly. So, we forced ourselves into the business. We forced an intervention to get them a full-time transformation consultant.

And we also are supported by a number of other key customers. Some of them are direct competitors of ours who have actually put people on site to help manage and get control of their production and fabrication operations. It's way more intrusive than we've ever had to be involved with a supplier.

So, the problem we now have, Chris, in terms of handicapping fourth quarter is how many of the seats do we think they're going to be able to deliver? The build cadence now is any bus that's sitting against a fence that's completed and waiting the seats or a full set of seats or parts is the number one delivery. So, we've rescheduled basically all of our demand from that supplier.

What we don't know is how fast that business will get into control. And, therefore, do we need to continue to slow the line rate down, expand the line rate or increase the line rate, and how many of those offline buses will get fixed?

So, the downside is that we put a wide range in the fourth quarter because as of today, we don't actually know the pace at which they're going to recover. I believe they'll recover. I'm very confident in our team that's working inside that. We've got the guy that runs our entire fabrication business, which is like a $400 million business inside there helping them to chart their course. And the wide range reflects uncertainty of the pace of recovery, not whether they will or not recover.

Chris Murray
Okay. And then maybe just another piece of the question to this. And I appreciate it's seating. It's not like, you know, something that you'd have to take the bus apart and put it back together again. If the seats for whatever reason show up, what does it look like to actually get them into the bus and get the buses finished, approved? Is this something short? Are you going to run into constraints with inspection, you know, just try to figure out like how fast you can rectify?

Paul Soubry
Well, that's all part of our wide range, Chris. And you've been to our facilities many times. If a bus is fully built, but waiting all the seats, the seats show up. It's not that -- it doesn't look like they come into FedEx box and we put it on and deliver it, right? There's X number of installation hours. And then in some cases, customers have signed off on the bus quality subject to the seat installation, and then they'll inspect it on site.

In some cases, the customer said, no, I want to come see the buses inside your facility before you can ship them. So we've got various buses at different stages of that. There is no question customer inspection and approval by the customer is also one of the pacing factors.

It's not like a taillight, we put it on the bus and ship it. There is going to be variation in the pace. That's again, part of the dynamic of the wide range of the fourth quarter guidance.

Stephen King
But Paul, I think it's fair to say the complexity of seats relative to some of the stuff we had. Much better for seat installation.

Paul Soubry
Yeah, it was a wiring harness. Yes, yeah. Good question.

Chris Murray
Okay. And then maybe just looking back at your -- I would just like to ask this question. Looking back at the challenge suppliers, I know we've talked about wiring harnesses and seats, I think for a good chunk of the year. You did mention that of the two, you know, kind of majorly impacted suppliers, the seat suppliers one. Can you just give us a little color on who the other one is? And is there anything there that could create an issue of this magnitude?

Paul Soubry
I don't believe so. As you may remember, Chris, and some of the people, the investors have been through our facility, we have different types of inventory labeled as different things. And so we have discrete part number, bus number parts that are dedicated to that vehicle.

We have common parts that are new flyer or MCI part numbers that can be potentially universal. And then we have Kanban or assembly type parts, nuts, bolts, washers, and those kinds of things. We were in the middle of a transfer from a supplier A to a supplier B to take track of all the Kanban systems. And that did not go quite as planned. Some of it are doing, some of it -- the translation and the implementation by our supplier. That's pretty well solved and will be solved over the next couple of weeks. It had some impact on a few line entries that we had to delay or change, but it is nowhere near the ramification of building a bus with having no seats or having no wiring harness.

I think the irony of the whole thing is that we're way better in terms of point at use of inventory as a percentage, right? It's up to 96 or 97 or wherever it is percent of parts in station. The downside is something like seats, whether it's a partial seat, a part off of a seat or a full ship set, you cannot ship the bus to the customer. And therein lies the long pole in the tent. We're beefing up our supplier vendor and vendor development team. Yet again, we added a bunch of people, we're adding more to it to make sure we don't get cut off guard.

In this situation, we were there, we saw it, we had people on ground, and only after a while we had felt -- because it wasn't getting any better, we felt we had to force ourselves and have some kind of a consultant and personal intervention into that business. We cannot afford them to get that much behind schedule again.

Chris Murray
Okay. My other question is just thinking about like the 2025 and longer-term guidance. I mean, irrespective of the seats and it kind of feels like, you know, we're call it six to eight weeks away from a solution. But when you think about the 2025 guide, I think you made the comment that even when you set the guide, the world was a bit of a different place than it is today.

In a lot of ways, a lot of things have gone maybe more in your favor than not. Can you talk about, you know, how you're thinking about the 2025 guide? Maybe what's a little bit better than you would have originally thought when you set that first guide? What's changed and what kind of thoughts are you having about production rates? And I mean, you talked about some investment in the business to give you more capacity in Canada. But is there anything else like that would let you maybe grow beyond what you would consider the normal historical rate?

Paul Soubry
Sure. I'll start it off just by context, and then Brian can give you a little bit more color on the individual elements. The conversion to zero emission vehicles, while we all get intuitively what that means, is an order of magnitude more complex on the production lines, or hell, every way through the design, the sourcing, the production, the commissioning of electric bus, even the acceptance at the customer location.

So in addition to the line rates that are critical for that, the mix of zero-emission versus ICE bus is another issue. The third issue that is going to play into us next year, and we haven't finalized our schedule, is the mix between a 40-foot bus and an articulated bus that has two halves, one that has a propulsion system in it and the other which has basically the driver's compartment. And so all of those things add to the complexity of the schedule and the mix dynamics.

So Brian, maybe some color on Chris' question.

Brian Dewsnup

Yeah. Thanks, Chris. When you talk about positive and negatives, I would say where we are now, the backlog and the order book has been a very, very nice surprise -- not necessarily surprise, but situation in North America, the competitive environment and the margins in North America.

We've seen improvement aftermarket business, and the strength there is something that we really like and is a positive. We do have more ZEB experience now. We've got significant volumes that we've put through. We've got more experience in the field. We've got, I'll call it smarter customers who have them and know how to service them a little bit better now.

We have the Alexander Dennis vehicle launches, EV vehicle launches, largely behind us now for a couple of platforms. So we've got those vehicles beginning to enter service, and then the increased capacity in Canada as well. Like all of those are positives and point to a pretty good future.

A couple of lingering concerns, one, the UK bid environment, it's a pretty competitive environment, and we see that continuing, maybe a little bit more competitive than we would have thought. And then, of course, the supply environment, we're five years on from COVID. We would have expected that suppliers that have been with us for 20 plus years where we've, "never had a problem." We see a problem particularly with seats today.

And so that environment maybe isn't exactly where we want it to be. So that's kind of the balance between the positives and negatives that we see. And as Paul mentioned, we're working through what's a prudent line rate and what are the resultant kind of financials around that line rate.

Chris Murray
Okay, I'll leave it there. Thanks so much.

Paul Soubry
Thank you, Chris.

Operator
Your next question comes from the line of Krista Friesen with CIBC. Please go ahead.

Krista Friesen
Hi. Thanks for taking my question. Maybe if we can just speak on the liquidity and you proactively seeking that waiver, what's the scenario analysis that you ran where you need that waiver on the $50 million? Is that -- if the seating supplier essentially declares bankruptcy or how bad would it have to get for you to need to use that waiver?

Brian Dewsnup
Yeah, I think early on as we went in to assess the seating supplier, the more we got in there, the more kind of concern and downside concern that we had now. Where we are

today, we're smarter. We have actually our people embedded, and so we have more confidence in the recovery than we might have had.

But when we felt the need to go secure the waiver, we didn't have as much information and just prudent to plan for not necessarily the worst-case scenario, but as we looked at some of the downsides, we wanted to be a good partner with our lenders. And as we had the discussions with them about some disruption, we just kind of collectively thought it was prudent so that we could go out and have access to that in the case that we weren't able to secure milestone payments from customers and some of the other things that we've been working on.

So our expectation is that we won't need to use it, but in an abundance of caution, we went out and made sure we communicated with our lending partners so that they were aware. And they've been extremely supportive and cooperative. And you've seen a couple of things that we've talked about where they've been supportive and they continue to believe in the business and the bright future we have ahead.

Paul Soubry
Krista, I'll add another comment that maybe isn't as intuitive to a normal manufacturing business. Because we're highly customized, we've got a certain production schedule. We know the parts that we're behind from the seat supplier. If that seat supplier starts to deteriorate, obviously, we don't want to build more and more product that sits against the fence, so we adjust the production schedule.

The downside is if we're within about a six- to nine-week window, most of the parts are coming to us anyway for the rest of the bus. So inevitably, any changes to the line entry rate has not only cost of nonproductive labor, but has effectively parts coming in that we're not going to use for a longer window.

So to Brian's point, having the liquidity or the interest cover flexibility should we need it just gives us that more security. And quite frankly, given some of the challenges over the past couple of years, we'd much rather have that positive, mature, advanced conversation with the lenders than under duress saying, holy smokes, I need a waiver tomorrow, should I need it? And that was really the intent. I think the lesson learned from last time, really try and get out in front of these things.

Krista Friesen
That makes sense. And maybe just if I can ask, I know you've been asked this question on previous conference calls, but given the verbiage around the liquidity where you mentioned you have access to capital markets, is there an intention to issue equity or are you pretty firm in your belief that you're not going to go that direction?

Paul Soubry
So we have no intention unequivocally today to want to do that. We believe that we'll solve this seat issue. It may take shorter or longer than we thought. We believe that we'll be able to relieve the inventory, some of which we've got some advanced payments for,

some of which we've asked customers now not to have terms so that once we deliver it, they pay us real time. Some have agreed to that and some will go to normal terms.

We also believe that we have a plan for a much more stable schedule as we move into 2025. We have no intention of issuing equity. We believe that we can manage our way through that with the existing profile. The change earlier this year that I just can't stress enough, when we got support from APTA, our trade association, but also the FTA and the White House around what they called better contracting terms that allowed for clarity on milestone payments has been an absolute game changer for our business.

Now most of those advanced milestone payments unfortunately have helped us finance this crazy situation with seats, but that is a net positive to our business going forward where the vast majority of contracts we're bidding on right now have milestone payments embedded in them.

And as I said before in my statement, where we find ourselves in a probability of one or maybe only two bidders, we're all asking for milestone payments and therefore they're becoming far more commonplace than they were -- than we even had before. And that has fundamentally changed the current but also the future working capital profile of our business.

The non-unearned revenue that we have today and what we expect in the future is a material number.

Brian Dewsnup
And I'll just add to that, that as we continue to see the leverage ratios come down, we're no longer talking about being five, leverage ratio, five and a couple of quarters. We're there right now. We continue to project that to come down, so as that continues to come down to where we would expect it to be, we'll have access to other kind of dead instruments and things like that.

So we're definitely moving into a zone where even if we were to need some additional liquidity, we're in much better shape with the actuals and we're not talking about, hey, in six months or so, we're talking about the here and now with some of the leverage ratio improvement.

Krista Friesen
Okay. That's really helpful. Then maybe just on the milestone payments, it sounds like a lot of progress is being made there. I think I read a few weeks ago that L.A. Metro is adopting some of these recommendations for less customization on the buses as well. Are you seeing that from other municipalities?

Paul Soubry
So it's a really good question. So we'll talk to the task force mission. A, number job one was to deal with milestone payments. Job two was to deal with some clarification and

standardization of clauses that were far more balanced, like price determination, redetermination mechanisms in periods of hyperinflation and so forth.

The third leg on that whole priority was this customization. The first thing that happened is the FTA grants for 2024 for zero-emission or for charging infrastructure, part of their scoring criteria was based on minimized customization.

So, we've now started to see a lot more customers think that way when they're issuing their RFPs. We're starting to see more customers like L.A. that are being vocal about trying to get regional operators to have much more common fleets. That is not a light switch.

Remember, we've got a backlog that is based on a number of years of bidding that had customization, so it's not like it's going to impact 2024 or 2025 that much, but it is no question going to change the game. We think 2026, 2027, where we'll never get to pure standardization, but we might get closer to configuration than pure unadulterated customization. It's all net positive for the health of our business and our industry, but it's not a light switch.

Krista Friesen
Okay. That's great. Thank you. I'll jump back in queue. Thank you.

Paul Soubry
Thank you, Krista.

Operator
Your next question comes from the line of Daryl Young with Stifel. Please go ahead.

Daryl Young
Hi, everyone. Just with respect to the 2025 look, just trying to get a sense of some of the potential upside. Like, what's the magnitude of the pricing in those orders that's coming through that you've rejigged versus what you would have originally expected? It does sound like there's some positive upside there.

Paul Soubry
As we built the 2025 and we're in the process of building it, and you can see in our deck there, I think, Stephen, we've got it on Slide 25. There's a dramatic uplift in the average price of what we're bidding on right now.

And of course, the increase in price is a reflection of a couple of things. A, the zero-emission dynamic makes for more expensive components, battery packs of 200 grand versus a 30 grand engine, those kind of things.

The second issue is you have hyperinflation that has continued in some places, and in some cases, cost of components coming down. So there's movement on the -- let's call it input cost across there.

There's labor increases. We've seen some areas across the whole world have seen some jumps over the last little while. And then the fourth element is that we are -- because of the competitive environment in most of our markets, we have increased our margin. So, you can just see on that one slide again, 25, you can see three years ago, the average transit bus in our backlog was 516. It's now 860. And that number is only going to go north as zero-emission goes up.

And as we continue to bid strategically where we think there's the best opportunity for return on the capacity that we sell to them. So we've tried to think about that. The doubt, as Brian outlined, the challenges with next year is we don't want to try and ramp up the volume too fast as we get a higher percentage of zero emissions, because that in itself adds an element of risk.

And like we got just snooker here right now with the seat supplier, we're going to spend way more time and more focus and more and more making sure that the vendors are capable of ramping up not only the volume as we increase, but change the mix alongside us.

So, look, we're going to finalize our 2025 plan before the end of the year. We pitched our first pass of it this morning to the board. Great conversation and dialogue. And we'll see what that looks like.

Brian Dewsnup
And then the -- just to -- sorry, just to add a little bit to that as well, I think the average backlog is largely just the dynamics of the market is North America phenomena. And most of our order book in the transit business is full for 2025 at this point. So, a lot of the margin improvement and things may be reflected in 2026 more so than 2025, just to keep that in mind.

Daryl Young
Got it. And then with respect to this year, the -- and obviously the seating is the big issue, but you did mention the complexity of the ZEBs, what's coming through in the next quarter here and into 2025, like, are you realizing the same margin that you would have expected on those buses or is that complexity really bringing down the profitability of those buses compared to what you thought and how much of that might be impacted in that guidance reduction? Like is it 85% of the seats?

Paul Soubry
No, I don't -- yeah, it's the vast majority is supply disruption as opposed to the time or complexity of us building a zero emission. And we've built a bunch of them now, right? So, we're well at the learning curve.

We don't have really anything wildly new, for example, on the MCI or the new flyer side, we have more zero emission next year, we have more hydrogen fuel cells.

On the Alexander Dennis side, we still have some learning curve as we've now transitioned basically to the platforms, the third one is coming online and then the fourth as they go to the zero-emission platforms.

But I would say that the disruption in the guidance adjustment is a direct correlation of the seat dynamic, specifically as it relates to what happened to us in Q3 with a little bit of stunted deliveries. And as we now introduced a wider range for the fourth quarter.

Daryl Young
Got it. And then just one last one on the balance sheet, the last couple of quarters, you've talked about the potential to maybe turn out some of your higher cost debt that effectively off the table given -- or I guess off the table until you kind of get through these seating issues or is there still an option to continue advancing that restructuring of some of the notes?

Brian Dewsnup
We continue to have some really good discussions with the banking syndicate and other lending partners. Right now, we're really evaluating our current year financials as I think it was pointed out earlier, we have a fairly wide range in Q4. And so, as we look to narrow that range and get closer to the end of the quarter, it's really more about timing and when is the optimal timing to go to market so that we can realize the material savings and interest and whether that's Q1 or Q2 of next year, I'm unsure at this point. And I think we committed to give you an update with Q4 earnings release in a few months.

Daryl Young
Okay, great. Thanks everyone.

Paul Soubry
Thanks, Daryl.

Operator
Your next question comes from the line of Cameron Doerksen with National Bank Financial. Please go ahead.

Cameron Doerksen
Yeah. Thanks. Good morning.

I wanted to, I guess, ask you about your thoughts on the new U.S. incoming administration. I mean, obviously, it's going to be hard to maybe predict what they're going to do, but I guess maybe I want to understand better, like a downside scenario here on public funding transit in the U.S. So, maybe if you could just provide a little bit of your thoughts on where your confidence, I guess, that the current funding bill is going to continue as planned. And how supportive the next administration is going to be for public transit funding?

Paul Soubry

It's a great question, Cameron. And I wish I had a crystal ball. But let's look a little bit at history and let's also kind of get a status quo. So, first of all, transit funding for the last 20, 25 years has, for the most part, been a bipartisan issue because it's not just green transit that's big right now. Trying to get congestion, trying to get pollution out of the cities, trying to get more people out of their cars and, therefore, efficiency through cities and so forth has been supported by both Republicans and Democrats.

Number two, the previous Trump administration took over and supported Obama's administration's FAST Act that went through, I think it was 2016 to 2020, and then, in fact, Trump extended it into 2021. Number three, the Infrastructure Investment and Jobs Act is currently in place until 2026, and funding from that act is currently and will be continued to use to purchase the 27 and 28 bills. It's hard to stay at this stage what a new administration's post-IIJA funding might look like, although our industry generally believes there's an expectation there will be continued bipartisan support for transit.

Now, as we are in a situation of very strong funding, we've seen a lot of agencies pushing to get their RFPs out on the street and get contracts in place prior to 2026. And so I think we rattled off in here the number of active bids we have, the number of bids already submitted, and the number of units in our bid universe, which, again, reflects fleet replacement plans, are reflective of what they're currently thinking.

I talked a little bit, I think, in Chris' question about the healthy contracting rules, which have made a better -- if Mr. Trump is pro-business, it provides a better environment for our industry in terms of pricing, pricing mechanisms and adjustments and appropriate things.

The other thing that I'll comment is, if somebody hypothesizes that Mr. Trump will not be as green in his outlook, that may be the case. But that's part of the reason we chose to be propulsion agnostic. We've seen a number of competitors recently go out of business or change dramatically where they only have a zero-emission offer.

We've chosen to be agnostic and continued ICE -- sorry, diesel, clean diesel, natural gas. We've seen an uptake in the last little while of hybrids, people getting closer to zero-emission. And then, of course, we're seeing strong zero-emission and fuel cells.

So, our ability to kind of continue to provide whatever they need, depending on their funding or their political environment, we think helps safeguards a little bit as opposed to people that are only zero-emission. But who knows what Mr. Trump and the administration might do. Right now, there's a lot of funding in place that will help -- only build our order book for the next couple of years.

Cameron Doerksen
Okay, I know that's good color. Just on the mechanics, I guess, of how the bus orders are funded, is everything that in your backlog, both firm and options, is that already appropriated money, i.e., it could not be clawed back in this scenario because it's already been appropriated by Congress?

Paul Soubry
That is my understanding, Cameron. Again, with the new administration, I guess the uncertainty is never -- you know, we really don't know what he could or might want to do. But our understanding is to put an RFP, that customer has to have secured appropriated funding.

And so, therefore, they're not just fishing for pricing when we see it, that they're actually planning to buy those buses and have the ability through those contractual mechanisms to exercise the options.

Cameron Doerksen
Okay. That's good. And just maybe a final line on, I guess, this issue, just around, I guess, potential tariffs that might come up, how would that potentially affect your business?

Paul Soubry
So, we've been doing a little bit of work on trying to understand the impacts of tariffs. Today, most of our stuff is built physically in the United States for the United States market. We don't export a lot out of the U.S., other than in some cases, we'll build some parts that send to Canada.

The other end, where we build something in Canada, a shell, most of it is used with U.S. steel or U.S. components and so forth. We also live in the environment of the USMCA, where some things may have a tariff on it, but the tariff gets waived out because of the, basically, the old NAFTA tariff codes don't apply to some of those components.

So, we're basically concerned, obviously, but not disastrously worried that there's going to be a massive impact. It may change some of the things we do today in Canada. We may want to push more to the U.S. going forward and those kind of things. We have plants on both sides of the border. So, we'll continue to try and adjust if and when this kind of stuff comes through.

We also have this element, as you may remember, in most -- well, all of our contracts have what's called a regulatory clause. And so, if the government changes the emission standards or changes the -- government puts in a tariff, we have the ability to go back and negotiate with the customer on anything that's driven from a government change.

So, again, until we see exactly what things happen, we feel comfortable to be able to manage our way through it.

Cameron Doerksen
Okay. No, that's great to hear. I'll leave it there. Thanks very much.

Operator
I will now turn the call back over to Stephen King for closing remarks.

Stephen King
All right. Thanks, everyone. Thanks for your questions, and thanks for those listening in on the webcast. As always, you can find all of our materials on our website, and please don't hesitate to reach us online. We have our email contact information, or you can get me at Stephen.King@nfigroup.com. And we look forward to speaking with you again early in the New Year.

Thanks. Have a great day.

Operator
Ladies and gentlemen, that concludes today's call. Thank you all for joining. You may now disconnect.