NFI Group (2021 Q3 Results)

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Corporate Speakers:

- Stephen King; NFI Group Inc.; Group Director of Corporate Development & IR
- Paul Soubry; NFI Group Inc.; President, CEO & Non-Independent Director
- Pipasu Soni; NFI Group Inc.; Executive VP & CFO

Participants:

- Nauman Satti; Laurentian Bank Securities, Inc.; VP
- Daryl Young; TD Securities Equity Research; Mining Research Associate
- Cameron Doerksen; National Bank Financial, Inc.; Analyst
- Maggie MacDougall; Stifel Nicolaus Canada Inc.; Head of Research
- Jonathan Lamers; BMO Capital Markets Equity Research; Analyst

PRESENTATION

Operator: Good day, and thank you for standing by. Welcome to the NFI 2021 Q3 Financial Results Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions)

I would now like to hand the conference over to your first speaker today, Mr. Stephen King, Group Director, Corporate Development and Investor Relations. Sir, the floor is yours.

Stephen King: Thank you, Hazel. Good morning, everyone, and welcome to NFI Group's Third Quarter 2021 Results Conference Call. This is Stephen King speaking. Joining me today are Paul Soubry, President and Chief Executive Officer; and Pipasu Soni, Chief Financial Officer.

On this morning's call, we will be walking through a results presentation that can be found in the Investors section of our website. While we will be moving the slides via the webcast, we will also call out the slide numbers as we go through the deck for participants on the phone.

Starting with Slide 2. I'd 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. You are advised to review the risk factors found in NFI's press releases and other public filings on SEDAR for more details.

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

On Slide 3, we have 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 production levels and delivery statistics. The majority of our vehicles represent 1 equivalent unit, while an articulated 60-foot transit bus takes 2 production slots and, therefore, is equal to 2 equivalent units.

On Slide 4, for those of you new to the NFI story, we are a leading independent global provider of sustainable bus and motor coach solutions. We operate with a four-pillar approach focused on vehicles, infrastructure, aftermarket support and workforce development.

Turning to Slide 5. Our purpose and mission is simple: we exist To Move People. In other words, our products move precious cargo. We are focused on designing, building and delivering exceptional turnkey mobility solutions. On this slide, we've also included our stakeholder matrix drives our strategic decisions and the core operating principles that govern our behavior.

I'll now pass it over to Paul to recap the quarter.

Paul Soubry: Thanks, Stephen, and good morning, everyone. I'll begin on Slide 6 titled Executive Summary.

Similar to other global manufacturers, NFI's third quarter results and operations were impacted by supply chain disruptions that caused a rapid deterioration in availability of critical parts, components and chassis and negatively impacted our production. We responded quickly to these issues through the prudent, albeit difficult, decision to temporarily reduce new vehicle input rates and by idling some of our facilities and by adjusting production levels in others.

We anticipate that these actions will assist us in controlling costs, lowering our working capital investments and preserving cash until supply availability and the reliability of delivery improves. Our customers have been very accommodating and working with us as we adjust production and delivery schedules in response to these near-term disruptions.

In addition, our banking partners/credit syndicate have been very supportive and assisting us in focusing on our long-term business objectives while managing near-term challenges. We're currently in ongoing discussions regarding additional financial and covenant flexibility for 2022 as we work through these most recent supply chain disruptions and the impacts of the other realities of the COVID-19 pandemic.

There were numerous positives in the quarter, with the NFI Forward optimization efforts realizing several key milestones that have permanently reduced our fixed cost base. With expectations of a $67 million savings in 2023, NFI Forward will drive margin improvement and increase returns on invested capital as our volumes recover.

Even in the face of the pandemic and the supply chain-related challenges, our aftermarket segment saw significant year-over-year growth, with a record adjusted EBITDA for the second consecutive quarter.

There are a number of key forward-looking metrics that we track that have also increased in the quarter. First, our active bids are up 11% from the same time last year. Right now, it is the highest number of units that we've submitted for bid since 2017 quarter 2 at 6,307 submitted equivalent units under bid. And our 5-year total bid universe is up 7%, with over 38% of that universe being zero-emission buses. We anticipate that this strong demand and growth in procurements will continue, driven by robust levels of government support in all of our core markets. This bid activity is anticipated to generate revenue and backlog growth.

We've also seen increases in public transit ridership data and a sooner-than-expected return in the private market for leisure travel.

NFI is playing a leadership role in the evolution of zero-emission transportation and we saw several major milestones this quarter. Zero-emission buses are now 21% of our total backlog, up from 16% just last quarter. Our battery- and fuel cell-electric vehicles have now traveled over 50 million electric zero-emission miles. We were also awarded some very large EV awards in California, Virginia, New York, Nevada, England and Ireland, and we announced entry into the Australian market via strategic partnership with a local player.

NFI zero-emission buses are operating or on order in 15 of the top 25 transit agencies in North America and are used by 10 of the top 15 transit operators in the United Kingdom.

So far this year, we've completed a zero-emission charging Infrastructure Solutions projects in 9 cities, with projects in progress in a further 19 cities currently. And we remain on track for approximately 20% of our annual deliveries this year to be from zero-emission buses.

Very exciting for us this week: our Alexander Dennis double-deck buses and the U.K.'s best-selling electric bus are on display at the United Nations 26th Climate Change Conference of the Parties, or COP26, in Glasgow, Scotland. Our vehicles are also providing zero-emission transportation to world leaders during this event, and we're really proud to have worked with our customer partners, National Express and Stagecoach, at the event, highlighting our product and their commitment a zero-emission future.

Next, we'll have 100% zero-emission bus offering on display next week, with all of our companies showcasing their vehicles at the American Public Transportation Association, or the industry association called APTA, EXPO, which is North America public transit event. More than 8,000 in-person attendees have signed up, which is a massive amount given what we've gone through the last 2 years. And all will be able to see our lineup of electric and fuel cell-electric buses and coaches, all equipped with NFI Parts proactive air and surface purification systems.

Recognizing the need to deal with global warming, which demands significant reduction in greenhouse gas emissions over the next decade, countries around the world have made the landmark commitments to GHG reductions. There's never been more urgency on the design and delivery of mobility solutions that are clean, safe, accessible, efficient and, most importantly, reliable. This is NFI's core business, and we look forward to assisting governments and our customers achieve their operating targets.

I'll now turn it over to our CFO, Pipasu Soni, to review NFI's third quarter financial results. And I'll be back shortly to give you an update on our outlook.

Pipasu Soni: All right. Thanks, Paul. Turning to Slide 7, we have our backlog and new vehicle deliveries. Throughout the year, we continue to be at or above our historical win rates and are seeing a significant pickup in bid activity in our biggest revenue business, New Flyer.

Due to delays in new awards in both North America and U.K. transit operations, you will see that our backlog was flat in the current quarter. During our 2021 Q4 update, we expect to provide an update on the results of the recent pickup in bid activity. Currently, all signs point to positive momentum. Our backlog remains at a robust 8,103 EUs with 21% being ZEBs.

As we flagged in our September 17 press release, the supply challenges that we have been successfully maneuvering have finally caught up with us. We are seeing even more of our suppliers delaying or reducing shipments of parts and components. This impacted our deliveries in the quarter, as we consciously reduced production rates to minimize WIP buildup and cash consumption.

Turning to Slide 8. As expected with the supply challenges, our total revenue decreased by 26%. We did have some bright spots in the quarter with a greater number of ZEB deliveries and a greater number of higher-priced motor coaches sold in the period.

In addition, quarterly Aftermarket revenue was up 21% year-over-year despite being impacted by supply chain disruptions and the COVID-19 pandemic. The improvement was driven by increased volumes in all geographic regions. Quarterly Infrastructure Solutions™ revenue also grew by 10% on a year-over-year basis.

For Adjusted EBITDA, with the lower production rates resulting from the supply challenges, we had a year-over-year decline of $30 million.

Also with constantly changing production schedules resulting from navigating part shortages, we experienced variable production cost increases from labor to freight.

We also had less government support this quarter versus 2020 Q3.

As mentioned earlier, the bright spot to this quarter was the Aftermarket business segment, where we had record EBITDA for the second consecutive quarter. In addition, we also saw increased sales from the company's Infrastructure Solutions division and $60 million in savings generated by NFI Forward.

Going forward, we expect volume recovery and margin improvement will replace the impact of wage subsidies received during 2020 and 2021.

Free Cash Flow in 2021 Q3 decreased by $13.9 million or 54% compared to 2020 Q3, mainly due to lower Adjusted EBITDA in combination with higher lease obligation payments as the company made payments related to leases deferred by lessors in 2020 Q3.

The decline in Free Cash Flow was partially offset by lower cash interest expenses, lower income taxes paid and NFI Forward savings.

Liquidity at the end of the quarter was $320 million, a decrease of $69 million from the previous quarter. The decrease was due to higher period end inventory balances resulting from supply chain challenges, with expectations for strong cash flow generated in the fourth quarter, we expect to end fiscal 2021 with more than $400 million in liquidity.

Throughout 2021, a key priority across the company has been working capital management. The teams have done a phenomenal job navigating a very difficult environment while focusing on the controllable levers of working capital. As you may expect, the escalation of the supply chain challenges had a material impact on working capital days, increasing to 68 days compared to 62 days at the end of 2021 Q2 and 60 during the same period last year.

Going forward, we anticipate continued improvements to working capital metrics, although supply chain challenges, product mix and seasonality may cause some quarterly variance.

Turning to Slide 9. Our tax structure includes fixed and variable components based on profitability and impact of nonrecurring discrete items for which we normalize. As you know, we have a complex tax structure that we intend to unwind at some point in the future. This complex structure, combined with current low level of earnings before tax results, it challenges predicting tax rates. We do, however, anticipate that our minimum fixed tax expense will be between $8 million to $14 million, while our variable taxes will be based on a range of 21% to 23% of adjusted pre-tax earnings for the year.

During the third quarter, fixed taxes combined with negative tax impacts from currency fluctuations to generate a total adjusted tax expense of $1.3 million on an adjusted loss before taxes. We may continue to see these impacts during the remainder of the year.

On Slide 10, you'll note that our net loss for the quarter decreased compared to the same period in 2020 as we incurred lower restructuring and COVID 19-related costs.

Adjusted Net Loss, which normalizes for nonrecurring onetime items, increased year-over-year, primarily driven by the same factors that impacted deliveries and revenue.

On Slide 11, we are reaffirming our adjusted 2021 guidance for revenue, Adjusted EBITDA and cash capital expenditures as updated in September 2021.

For the fourth quarter of 2021, we expect lower Adjusted EBITDA on a year-over-year basis.

Finally, a reminder that for 2021, NFI's first, second and third quarters were 13-week periods, while the fourth quarter is a 14-week period, making the 53-week fiscal year.

I would like to now turn things back over to Paul to discuss our longer-term outlook.

Paul Soubry: Thank you, Pipasu. I'm now on Slide 12. As I discussed earlier, we continue to see historic and transformational government support for zero-emission public transit vehicles that have either been approved or proposed in all core markets. We also expect more government focus across the globe and financial commitment following the outcome of COP26 in Glasgow. These announcements are very encouraging, but they're complex and, in some cases, they're still going through the approvals and negotiations process.

As such, we do not yet have all the details on when all proposals and funds will materialize into actual bus buys. Generally, –in North America, it's anywhere between 12 to 18 months from the time a bid is released before we actually see an impact on delivery buses and our financial results. We are very encouraged by the government support.

I'll now turn to Slide 13, which is very telling for our business. It provides the latest update on what we call our North American public customer total bid units, something New Flyer created back in 2008. And as I mentioned earlier, active bids or where we have submitted or are in process of submitting a proposal, meaning they have the most significant near-term impact on our business, are at levels not seen since the second quarter of 2017.

We have over 6,300 units in bids where we've already submitted a proposal, and nearly 600 units were bids we have just received. There are over 180 active competitions in process in the North American public transit market alone.

The forecasted five-year North American industry procurement bid universe, which is developed through detailed discussions with individual transit agencies and from their published fleet replacement plans, an indicator of forward demand, has started to rebound and it was up almost 10% quarter-over-quarter. The increase in long-term forecast is primarily a result of transit agencies recovering their forecast and formalizing their short- and long-term procurement plans as they recover from the COVID-19 pandemic and as they learn more about the access to multibillion-dollar funding programs that have been announced or launched by the governments of Canada and the United States.

As of 2021 Q3,10,223 units or 38% of the total bid universe is zero-emission buses, highlighting the ongoing evolution to zero-emission transit. As we've always said, it's not if, it's a matter of when. And clearly, it is an evolution.

We have also continued to see increased uses of purchasing schedules, which include state and national contracts and cooperative purchasing agreements. Since 2018, NFI has received more than 650 individual vehicle awards from these schedules, which highlights their growing popularity with the North American transit agencies as a cost-effective and efficient bus procurement tool.

And ARBOC, through its dealer, was recently named on one such large contract with the California Association of Coordinated Transportation or CALACT, which is one of the largest state transit associations in the United States.

A reminder that these schedules are not recorded in NFI's backlog. And as such, they do not have defined quantities allocated to NFI or any other OEM. Once a customer purchases a bus using one of these agreements, the purchase order is recorded immediately as a firm order.

Turning to Slide 14. This shows NFI's targets through 2025. While there are no questions being near-term challenges from the pandemic and the resulting stock supply chain and the logistics issues, we remain well positioned for our previously announced long-term targets, with reasonable assumptions around market recovery to pre-COVID-19 levels, an increase in zero-emission bus sales and cost reduction through NFI Forward, we maintain our expectations to grow revenue to $3.9 billion to $4.1 billion and adjusted EBITDA of $400 million to $450 million by 2025. Nothing has changed in our longer-term outlook; the path to recovery is slightly muted given today's realities.

At NFI, we believe in delivery of long-term sustainable transportation solutions. And this drives our decisions and our operations. The current operating environment has been challenging to say the least, but we made tremendous strides in optimizing our footprint and adapting our structure. Through a lower cost base and heavier focus on working capital management, we will drive significant improvements in our return on invested capital as we see our markets recover through 2025. All of our key forward-looking metrics suggest this recovery has started and will continue to gain steam, especially as we move into the second half of 2022.

I'd be remiss if I didn't comment or shows tremendous support from our workforce, our employees, our team members, from our customers and their patience, from our Board and from our credit partners and, most importantly, our shareholders in this case, in all the support we've received navigating through today's realities, but the long term continues to be very bright and exciting for our company.

I'll now turn it back to Stephen to summarize today's discussion, followed by opening the call for analyst questions. Over to you, Stephen.

Stephen King: Thanks, Paul. Turning now to Slide 15 for a quick recap. The NFI Forward initiative continued to optimize our operations, with Adjusted EBITDA savings of $16 million in the quarter and $59 million since inception.

The quarter was impacted by global supply chain challenges and the ongoing COVID-19 pandemic disrupting production deliveries and customer order timing. These issues will continue to impact fourth quarter 2021 and first half 2022 results.

Bid activity in the overall bid universe increased, and we achieved the highest level of submitted bids since the second quarter of 2017.

Increased order activity, combined with additional expected government support for transit, supports our view production volumes will start to return to more normal levels in the back half of 2022.

We reaffirm our full year 2021 guidance and continue to anticipate 20% of our 2021 deliveries will come from ZEB.

We are focused on achieving our ESG goals through initiatives aimed at reducing our internal footprint while creating equitable access to mobility and workforce development. We are leading this evolution to a zero-emission future, with expectations for top line revenue growth and adjusted EBITDA performance in 2025.

We'll now open the line for analyst questions. Hazel, over to you.

QUESTIONS AND ANSWERS

Operator: (Operator Instructions) Your first question comes from the line of Nauman Satti from Laurentian Bank.

Nauman Satti: We're a few weeks into the fourth quarter, how has the supply chain issues sort of sequentially worked out? Has it improved or do they continue to deteriorate? And what's really the most challenging in terms of past procurement? Is it just limited to chips or chassis? Or what's the most troubling part here?

Paul Soubry: Well, it's a really good question. And of course, every day and every product we have in every facility is slightly different. The additional realities associated with the microchip problem, and of course, as you can imagine, the number of parts on all of our different buses, we don't buy those microchips or processors directly, we get them from components that we buy from suppliers. That has had the primary impact and continues to be one of the biggest issues associated with whether it's engine delivery or subcomponents on the bus or chassis.

But we continue to manage. We don't expect it to bounce back overnight. All we have to do is read the realities of our automotive friends and what they're doing to manage that. We've expected a bit of a muted recovery all the way through to 2022.

There are other parts that pop up every day. There are issues associated with, in some cases, aluminum extrusions. In some cases, it's plastics, or certain subcomponents like wiring harnesses or electrical components that relying on individual pieces that ultimately come from China and other locations.

Has it gotten better in the first couple of weeks of fourth quarter? Every day is different. One day, we solve a problem on one part and another part pops up. So it continues to be a day-by-day kind of dynamic. We are making facility decisions on a week-by-week in terms of run rate and load. We're working very cooperatively with our team members and our union partners to try and adjust to accommodate those kind of things. And all that to say, it's not really any better. It's a continuous slog at this point in time. And it's not an NFI issue, every single one of our competitors, anybody in our space has exactly the same dynamics and issues. And we don't really expect to see a material change to the stability of the overall supply chain until we get into 2022.

Nauman Satti: Okay. That's very helpful. And when we think about the replacement cycle of some of these transit buses, there's an element, or historically, we have thought that the battery costs would come down and that would make them more attractive versus the traditional ICE ones. Now that with these cost pressures, it's unlikely that we'll see the same sort of battery cost reductions that we saw previously. Has that changed something on the client front or the conversations that you have with clients around that?

Paul Soubry: No, I don't think so. I mean intuitively, if the market was elastic or responding that quickly, you could see price changes in shorter windows. We don't have a market like that. Our customers are working to 5- or, in some cases, 10-year fleet replacement plans. They are continuing to buy ICE conventional or hybrid vehicles to manage their fleets over the next 10, 12, 15 years. At the same time, they continue to, as we talked about in our statistics, increase the percentage of zero emission buses.

The government support that we've seen and talked about, whether it's Canada, the U.S., or U.K., reflects both the increased cost of a zero-emission bus, but also the reality of needs for charging and electrical infrastructure.

So I don't think we've seen any change in anybody's strategy or plans associated with the ultimate evolution to zero emission. There is still a legacy business that is very strong and continues to operate. You've seen a couple of announcements recently from us around some significant CNG or even hybrid-type orders. But the price elasticity around battery pricing is going to continue to come down over the next 1, 2, 3, 5, 7 years, whatever that period is. I don't think that's influencing buying in the short term at all.

Nauman Satti: Okay. Just one last one from my end. When I look at the bids in process for Q2 to Q3, there's quite a bit of drop. So I just want to get a sense, the recent bids that you've had which you got the results for, what are the results like? Are you still maintaining the market share? Is there something changing there? Or it's just how historically it has been, it's trending the same way?

Paul Soubry: Yes. We put that chart on Slide 13 to try and help people understand. And in some cases, it might be possible to misinterpret. The number of active bids has continued to go up. Remember that we don't submit a bid and a customer decides on it the next day. They go through their evaluation processes. In some cases, there's face-to-face meetings or negotiations. In some cases, there's a rebid or best-and-final offer-type process and so forth.

So the up and downs of the new bids coming in, it really isn't all that significant. You've really got to add both the bids we've received and the bids we've submitted. That total active is the real metric you should keep your eye on. And it's actually up literally 10% or 11% year-over-year. We've actually seen some positive movement over the last, let's call it, 3 months or so around the recovery of ridership and the impact that, that have on our transit agencies planning their routes and their fleets. So we're seeing that as very positive.

Keep in mind, if you add those 2 numbers together, the bids in process, the bids submitted, it's as high as we've seen in the last 5 years. It's very encouraging from where we sit.

Pipasu Soni: And Nauman, this is Pipasu. Just maybe just to add to that, one of the things we may want to add is, obviously, from our win rate perspective, we are seeing slightly better than historical. And it's particularly in the ZEB arena at the moment, especially in the New Flyer business.

But again, from our perspective, obviously not losing any market share is what we've been seeing in the last several months.

Operator: Your next question is from the line of Daryl Young from TD Securities.

Daryl Young: Just a quick one on the Infrastructure Solutions group. I noticed in your release, you mentioned that you've completed 9 projects so far. And then you have an additional 19 projects in different cities. It seems like a pretty quick ramp-up. And would that be a precursor to order flow? Obviously, the backlog is growing. Or sorry, I should say the universe is growing. But just a little bit more color on sort of where those 19 cities are and what's happening there?

Paul Soubry: It's a really good question. And, as you know, Daryl, we'll take half good credit on strategy and half almost being forced into the frustration of trying to deliver zero-emission buses and operators maybe not being ready on the electrical infrastructure, the charging infrastructure side. So we cobbled together a team, and now we've expanded that team and added some really solid resources to work with our customers.

Not every customer is going to want the bus provider involved in the infrastructure. Big cities, Toronto, New York, even Ottawa, others, are handing some of that charging infrastructure or facility infrastructure over to the major utility agencies inside the states or the provinces. Small and medium-sized operators are, no question, wanting a bit of a bundled solution to ensure that the bus and the electricity and the charger work as a solution. We call it a bit of an ecosystem, not just a vehicle.

It's an area that we're studying deeply. It's an area that we're deploying more resources on. Roughly, today, every time we have 10 bids for zero-emission in North America, 5.5 or 6 times out of 10, we've got a charging infrastructure offering to go with it. We're working with all kinds of different sizes of agencies, everything from Antelope Valley, a customer in California that is buying MCI electric coaches office, to smaller agencies like Culver City or Knoxville, L.A. Metro. We have a project with them on a specific charger at one of the locations.

We've worked with Minneapolis, Metro, Rochester, Minnesota, St. Louis. So it's quite varied. Clearly, it's a reflection, in our view, that the future for our business is not just about the bus, it's about the bus and how it works inside an ecosystem, and we're going to continue to participate in that. So we're really pleased with the progress and performance of that team.

Pipasu Soni: Yes. And I think maybe just a little bit to add there. Again, it is a leading indicator of our ZEB sales, which it kind of is from our perspective. And it's a positive sign that our customers are starting to get ready for those bus sales, which is obviously something we want.

Daryl Young: Got you. Okay, great. And then when you look at -- I mean, you said you're holding market share. Would you see any shift or changes in who those customers are for the ZEB orders? I guess, just any transitory shifts? Or is it mostly people that bought NFI buses in the past are buying NFI electric buses now?

Paul Soubry: Well, as you know, Daryl, we've talked in the past, the selection criteria for every customer is different. There are many of our current customers that have in their selection criteria past performance, the requirement to submit case studies or reference customers, the ability to demonstrate performance and all those kind of things, we're sitting in a really good position there. We have a very wide distributed fleet with customers that have a past and a history and a relationship.

And, of course, an electric bus, as much as we'd like to think it's plug and play, it's a very complex vehicle. They need to have a very significant field service team infrastructure, as well as partnerships with all of the major component suppliers or charging suppliers, charging equipment suppliers and so forth. This has been really, really critical.

I wouldn't suggest that we've seen new types of customers or we've lost customers. As we transition, it will be the continued evolution of our business. Case studies go an awful long way. We've seen some really important bids where we've proposed and won based on our track record and our performance of delivering zero-emission buses and supporting them.

We've also seen some of our competitors have some real challenges, whether it's structural issues, range, performance issues and so forth, which goes back to the electric propulsion. Electric propulsion is an important part of the bus; it needs to be reliable and perform, and to last 12, 15, 18, 20 years. This has been critical in some of those selections where we've won.

Pipasu Soni: Yes. And I think one other thing to add to that is some of our early adoption in ZEB, it's enabled us to sell to some customers who weren't typical New Flyer customers. So I think that's one that obviously was a fairly big positive for us.

Stephen King: And the only thing I'd add, Daryl: North America is a great success story with ZEB, but results have also been really good in international markets. In Ireland and New Zealand, two markets we weren't in before, we made a pretty big entry through zero-emission buses, battery-electric buses with ADL.

Operator: Next question is from Cameron Doerksen from National Bank Financial.

Cameron Doerksen: I just want to come back to the supply chain question again. I'm just wondering if you can comment on how NFI is doing relative to some of your competitors on supply chain issue. I guess what I'm trying to get at is whether there's any impact on your ability to win contracts here relative to other competitors that are maybe in a better or worse supply chain situation.

Paul Soubry: Good question, Cam, but I'll point back to the fact that it's not a short-term buy decision. Those customers take 8, 10, 12 months to make a decision on a vehicle. We haven't had a contract that we've bid and won and had it canceled because we can't get a bus any faster than our competitors. So it's not elastic like that in terms of a customer pivoting to say, hey, somebody else can get it to us faster. The customers have been tremendously supportive working with us to adjust pre-production meetings, online inspection of vehicles, post-build inspection, as well as acceptance and delivery. And so that's been really, really good and support from the customers.

Our competitors, while they will have a different supply chain for some parts of the bus, the same issues apply. I mean resins, plastics, extrusions, all the issues associated with microchips. The electrical connectors are universal challenges in manufacturing, let alone transit bus manufacturing or motor coach manufacturing. We haven't seen any competitor be able to make any delivery promises any different than we've been able to make. If anything, just our sheer size, we believe we're slightly ahead in the queue in terms of those customers supplying to us.

David White and our team who heads up supply continue to not only go to our suppliers physically now, but they are also moving down to Tier 2 and Tier 3 to help our suppliers, in some cases, small U.S. businesses, to help them navigate and negotiate the supply chain. There's been no change in business demand or change in selection associated with the short-term supply challenges or logistics challenges we're all facing.

Cameron Doerksen: Okay. No, that's good to hear. Second question for me, just on the motor coach market. I wonder if you could just talk a bit about the trends you're seeing there. And maybe more specifically comment on, I guess, the change in ownership of Greyhound. I know that they have not been a major buyer of motor coaches from you in recent years anyway, but the buyer of that business, FlixBus, I believe, has been doing a trial of one of your MCI electric coaches. So I'm just wondering if you can talk specifically about the potential opportunity there for you.

Paul Soubry: Well, it's a really good question, Cam. As we see, first, America, and now Canada move up and people moving again. And I'll admit, caught us a little bit earlier than we expected in terms of the recovery of some of the motor coach. Now they're still in a world of hurt, let's be honest, the private motor coach operator.

They did receive money in the last, call it, 3 or 4 months associated with the CARES Act in the United States which was very helpful for the ongoing support of those businesses. We are pleasantly surprised that Chris Stoddart and his team on the MCI side has done a really good job of working down the excess finished goods inventory that we had built up at the start of COVID-19. Chris is actively now working at restarting the private motor coach manufacturing line in the first quarter of next year, which is a reflection on our view of the market confidence.

We are really pleased with our decision, hindsight in 2020, to eliminate the significant pre-owned motor coach pool we had pre COVID, that at the beginning of COVID, we ended up liquidating. It has allowed Chris and his team to be far more flexible at working with customers around appropriate trade-ins and costing of those vehicles and the value that we put them on our balance sheet. So we're -- bullish might be a little bit too aggressive a word. We're really comfortable with the pace of recovery of private motor coach.

The second issue then you asked about is the FlixBus acquisition of Greyhound. Greyhound, historically, I'm going back 10, 20 years, was largely a motor coach fleet. And then over the last 5, 7, 10 years, we really haven't sold them -- other than some spare parts, we haven't sold the new motor coaches.

The decision for FlixBus whose business model is not to own the assets, but to use private operators to perform those routes, it's interesting now to see them actually moving into acquiring an operator. Whether that stays that way or they migrate more back to that using the private operators, we have a number of motor coach operators that have bought coaches from us that operate on behalf of FlixBus.

I think it's a positive for the industry that somebody like that, that has turned the industry on its head a little bit with how tickets are sold, how seats are reserved at the route structure, the pricing and so forth. I think it’s a positive sentiment that, in America, people are moving and you've got a premier player like FlixBus wanting to get deeper into the space.

So while we don't sell buses directly to Greyhound or FlixBus today, we're quite encouraged the impact that could have on the motor coach operators in North America.

Operator: Your next question is from the line of Maggie MacDougall from Stifel.

Maggie MacDougall: So first off, can you guys elaborate a bit on the strength in the aftermarket division during Q3? I saw that there was a retrofit program for Asia. And I'm wondering how much of that would be attributable to what we saw produced in the quarter and then whether or not that program will be continuing into Q4.

Paul Soubry: So first of all, we've had 2 quarters in a row kind of record Aftermarket numbers, which is really positive for our business. I think it reflects a couple of things. The fact that we have scale and size as the supply chain has ground down everybody's inventories; we are in kind of an enviable position of having the most inventory, the widest distribution network. And we're becoming, in some cases, clearly the place to come from a delivery and performance perspective.

I think I heard the other day, there's something like 80 coaches down in North America where the customer can't get a part to get that bus back on the road. So there's a reality of the operators now being impacted, not just on the delivery of new vehicles, but on spare parts. And we're in a really good position to be able to support that, which I think enhances the growth we've seen in that business.

The other reality is, as I mentioned before, as public transit agencies work their way back to normal operating size, route structures and deployments, that will help, that has helped.

And then the second issue is that now this recovery of the private motor coach operator both in the U.K. but also in North America has provided some growth in demand.

The Asia-Pacific retrofit is a very specific program for a customer in Hong Kong. It has been going on for probably the better part of three quarters of a year and will blend into the fourth quarter and the beginning of next year.

Having said that, that program is discrete. We also bid on all kinds of upgrades, retrofits, midlife programs, and we are cautiously optimistic we'll be able to continue the growth of our parts business into 2022 and beyond.

Maggie MacDougall: Okay. Great. And then just in terms of the timing around when the Winnipeg and St. Cloud facilities were idled, the announcement was made mid-September. Were those facilities idled in September? Or did that occur in Q4?

Paul Soubry: It's a really good question and maybe reflects we've got to continue to tell that story more clearly. As you know from seeing our facility, Maggie, in the past, it's not a normal production line that is building the same unit. Very highly customized vehicles with different designs, propulsion systems, parts that go on those vehicles.

Varying the rate from 40 a week to 30 a week is a very difficult dynamic because you have a significant degree of non-recurring engineering, you've got a supply chain machine, then you have the direct labor on the shop floor and all the support infrastructure. Rather than shutting the volumes down, or reducing them from 30 or 40 to 30 or 20 or whatever the number is, what we decided to do is to have windows of idling and still run the plants at exactly the same production rate, but have less work weeks.

So we have been, what Chris [Stoddart] has been doing, both at the motor coach facilities and the transit facilities in North America, is selectively working with his teams and with the workforce to adjust certain days off or weeks off to still keep the normal production rate operating at the same cadence but less actual work days.

So all that to say that's been actually happening since, jeez, probably March of this year. And Chris continues to manage that and will do so through the fourth quarter of this year and maybe into the first quarter of next year.

Pipasu Soni: Yes. And I think one of the things we may want to add to that, Paul, and you kind of mentioned this, so Maggie: we had a little bit of idling in September and additional in Q4, but again, these are all very short-term decisions based on the availability of parts and the availability to move the lines. That was really the majority of the decision points there.

Paul Soubry: Think of it as, think of it as not reduction of production rates, think of it as using no line entry days or no line entry weeks to idle the facility to let the supply chain catch up.

Maggie MacDougall: Right. It makes a lot of sense. So if I'm trying to think about margin and production throughput as we go through Q4 and into the beginning of next year, how did Q3 bus manufacturing operations compare in terms of working days or percentage of overall days working, however you want to frame it, versus prior quarters in 2021?

Paul Soubry: I don't have the production schedule in front of me in terms of the sheer number of production dates. I do know that you...

Maggie MacDougall: We can follow up after...

Paul Soubry: Okay. Yes. Just in the fourth quarter, for example, of this year, we will have, in the New Flyer factories, we will have basically 2 weeks of non-line entries. So

10 lost production days. But how that compares to each individual quarter or period previously, sorry, I don't have the detail off the top of my head.

Pipasu Soni: Yes, it's roughly comparable, but let us get you to the detail, and we'll come back to it.

Maggie MacDougall: Okay. And then one final question for me. I noticed in your MD&A, you've discussed seeking covenant waivers from your lenders. I'm wondering if you can give us a bit of an overview in terms of what your debt obligations are in the upcoming year. And how this current negotiation is going versus past negotiations, just given that there's a bunch of moving parts here with supply chain. You obviously got a good mid- to long-term demand picture. But clearly, you need parts to be able to satisfy that demand picture. So, some color on upcoming obligations and then how you expect that negotiation to play out.

Paul Soubry: Sure. It's a great question, and it's a really important issue for us. As you know, when COVID happened last year we worked with the syndicate and adjusted the covenants. We did the same in December of last year. And again, none of us knew whether we'd have wave 2, 3, 4, whatever of COVID. And none of us could have predicted the ultimate impact on supply chain because, ironically, we didn't really have supply chain problems in 2020 or even the first quarter of 2021 to the magnitude we have today.

So our issue is not liquidity and borrowing capacity, our issue is covenant calculation. And of course, with a soft Q3 for this year and projected relatively soft Q1 and Q2 of next year, our LTM will likely put us off-side on some of those covenant calculations.

The credit syndicate in our case, is 11 -- 11? Correct, we've got 11 banks in the North American syndicate, and there's 2 in the U.K. credit facility that we have. So there's a process. We're working. The banks have been incredibly supportive. Clearly, they're taking a long-term view, not a short-term view.

And we're very comfortable and confident that we'll get all that sorted out before the end of the year in terms of how those covenants need to look for the first half or second half of next year. But it's not a liquidity dynamic. We expect to be north of $400 million of liquidity by the end of the year based on the current receivable profile and delivery schedule that we have without having to do any real difference in terms of managing payables or managing any of our other commitments.

Pipasu Soni: Yes. And Maggie, just to add to that, just real quick. I mean you know this, but we have $1.3 billion in capacity, you could do the math with the $400 million that Paul kind of mentioned the liquidity. Our bank groups are very supportive, and we are having some of those discussions. So really, I'm not seeing any kind of issues with getting that covenant relief for next year, if needed.

Operator: Next question is from Jonathan Lamers from BMO Capital Markets.

Jonathan Lamers: On the continuing supply chain problems, you mentioned that, day-to-day, the team has been able to solve challenges on some parts. I'm curious, is there anything your procurement team can really do given the limited number of suppliers that allow you to stay Buy America compliant?

Paul Soubry: Well, that's the reality, Jonathan. I'll give you some examples. When Cummins says we can't get an engine because we can't get all the connectors and components and microprocessors, there's nothing we can do other than continue to work with them with adjusting our schedules and working with our customers.

The other end of the spectrum is a plastic DEF tank that's got some kind of sensor on it, our team going out, working with that supplier, figuring out how to maybe reverse or alternate, engineer the part, finding another supplier. And, within weeks, we're solving that problem, or within a month, we solved that problem.

The reality is we always have those issues, and we are able to solve them with the appropriate lead time to historically adjust our production issues. The reality is that compounding issues today make that much harder. So we solved the DEF tank problem.

Another one, the vast majority of the connectors that are on electrical harnesses are coming from China. And, of course, a bunch of them are either on route or sitting in containers or somewhere in ports. So the ability to work with different kinds of suppliers, whether it be domestic or international, to come up with alternate source, to get them to our wiring harness suppliers, to get them to get that wiring harness, that's just the ugly reality of today's blocking and tackling. We don't see those as long-term systemic issues, but it is a reality in the short term.

The other biggest issue is Chris'[Stoddart] decision to govern the inputs, because what we don't want is what we had in 2018 and 2019 where we had supply from our own KMG facility that created parking lot full of unfinished buses and which just sucks up working capital.

And then, the other reality, every hour that we miss on installing a part of the production line, there's 3 or 4 hours of retrofit time in the parking lot or in the field, and that's very expensive, it's very disruptive and has a direct correlation back on how we can efficiently run the stuff going through the product line.

So, as tough as it was from a people and a productivity and a cost perspective, I think Chris made the right decision to govern the capacity in the short term, while that supply team goes and manages and works with individual suppliers.

I can't stress how accommodating the customer base has been. They get it. They get the reality of both what the pandemic has had on us and them, but also the supply chain. And so we'll just continue to manage through that.

As I think you took from our numbers and our speaking notes this morning, Jonathan, the number of RFPs, the number of competitions, the quantity of units, the support of the funding is really, really encouraging. The issue is that we have to continue to manage from here to there. And we believe *there* is the second half of next year, just in what we're seeing in terms of recent awards and RFPs on the street.

Jonathan Lamers: Thanks. And one follow-up question. If inflation on basic components is unusually high over the coming quarters, will New Flyer be able to pass that on through the normal inflation adjustments built into the orders? Or will you need to reopen some previous contracts to protect your margins?

Paul Soubry: Well, it's a really good question but applies differently in every single case. In New Flyer's case, what we're building today was priced a year ago. And half or 60% of that bus has a specific quote from a supplier. The engine cost is x, the transmission cost is y, the window cost is z. There's no question there is an increase our freight surcharges or price escalation on certain commodities in the vehicle, and so we continue to manage that on a day-by-day basis. But it doesn't have and we don't expect it to have a material impact on our gross margin.

On future business, obviously, we are reflecting those cost increases in when we're converting options. There are PPI indices in the vast majority of our contracts to allow us to cover any of those cost increases. Or, where we're bidding for new work, we're reflecting the current cost of those materials.

So there is no question an impact on our business. We don't see it as a material impact in the short term. And, if anything, our price will be reflected in the future based on the inflation of that cost and the purchase price indexes that we have.

The private markets are a little bit different in terms of what we do in Alexander Dennis or in private motor coach, where we're negotiating a price. But in those cases, the negotiations are far closer to the time in which we build the product as opposed to having a year-long price out there with a cost increase in the time it takes.

So an issue, but I don't see it as a major issue.

Pipasu Soni: And I think, Jonathan, you also know the PPI index is very high. So we are able to pass that on, is our viewpoint.

Jonathan Lamers: Great. Thanks for the comments about the credit negotiations. Could you update us on how the Board is thinking about the dividend in the context of the recent discussions with the lending syndicate?

Paul Soubry: Yes, it's a good question. And the board continues to believe us as a management team that a dividend is an important historical part of the core reason why people invest in our business. It's not the be-all end-all, but it is an important part of our story.

We recently, as you know, continued that dividend. And the discussion with the Board and the banks, covenant discussions notwithstanding, is that the Board is fully supportive and committed to wanting to be a dividend-paying business.

Operator: I am showing no further questions at this time. I would now like to turn the conference back, please, Mr. Stephen King.

Stephen King: Okay. Thank you, Hazel. We only had one question on our webcast. It was about the private coach market, and I think we addressed that earlier.

And Hazel, I just want to make sure, before we wrap up, Chris Murray had mentioned to me, he might have a question, but if he's not on the line, then we'll close out.

Operator: I am not showing him queued up for a question on the line, sir.

Stephen King: Okay. Well, we will end it there. Thanks to everyone for your questions and for joining us today on the webcast or via the call. All materials are on our website. And we look forward to talking to you again soon. Thanks, and have a great day.

Operator: Thank you. This concludes today's conference call. Thank you for participating. You may now disconnect.