NFI Group Inc (2023 Q4 Results)

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

Participants:
- Tamy Chen; BMO Capital Markets; Analyst
- Cameron Doerksen; National Bank; Analyst
- Krista Friesen; CIBC; Analyst
- Daryl Young; Stifel; Analyst

PRESENTATION

Operator^ Ladies and gentlemen, thank you for standing by. Welcome to NFI's 2023 Fourth Quarter and Full Year Financial Results Call. (Operator Instructions)

Please be advised that today's conference is being recorded.

I would like now to turn the conference over to Stephen King, Vice President, Strategy and Investor Relations.

Please go ahead.

Stephen King^ Thank you, [Michelle]. Good morning, everyone. And welcome to NFI Group's fourth quarter and full year 2023 results conference call.

This is Stephen King speaking. And joining me today are Paul Soubry, President and Chief Executive Officer; Pipasu Soni, our outgoing Chief Financial Officer; and Brian Dewsnup, our newly appointed Chief Financial Officer.

On today's call, Paul and Pipasu will provide an update on our financial results, the operating environment, market demand, and our outlook. Brian will introduce himself and provide some insight on our financial guidance and his areas of focus as he assumes the CFO role.

This call is being recorded and a replay will be made available shortly. We'll be using a presentation that can be found in the Investors section of our website.

While we'll be moving the slides via the webcast link, we will also call out the slide numbers as we go. Starting with Slide 2, I would like to remind all participants and others that certain information provided on today's call may be forward-looking and based on assumptions and anticipated results that are subject to uncertainties. Should any one or more of these uncertainties materialize, or should the underlying assumptions prove incorrect, actual results may vary significantly from those expected.

In addition, certain financial measures we reference today are not recognized earnings measures and do not have standardized meanings prescribed by International Financial Reporting Standards, or IFRS. We advise listeners to review the risk factors, financial definitions, and non-IFRS measures found in our press releases and other public filings on SEDAR for more details. We also want to remind listeners that NFI's financial statements are presented in U.S. dollars, the company's reporting currency, and all amounts referred to are in U.S. dollars unless otherwise noted.

On Slide 2, we've included some key terms and definitions referred to in this presentation. Of note, zero-emission buses, or ZEBs, consists of battery-electric, hydrogen fuel cell-electric, and trolley-electric buses; equivalent units, or EUs, is a term we use for both production slots and delivery statistics. Slides 4, 5, and 6 provide a brief overview of our company.

For those interested in a more in-depth introduction to our business, please visit the Investor section of the NFI Group website. Slide 7 provides the latest statistics showcasing NFI's leadership in zero-emission transportation, what we call the ZEvolution. Since 2015, NFI has delivered 3,603 EUs of ZEBs that have completed over 150 million electric service miles in more than 150 cities in six countries. Our Infrastructure Solutions team has also installed over 445 chargers, totaling 72 megawatts of charging capacity since 2018.

Demand for ZEBs continues to accelerate. 36% of our current backlog are ZEBs, and, based on our analysis, we see over 50% of anticipated customer purchases over the next five years being electric vehicles. We continue to project that at least 40% of our 2025 deliveries will be ZEBs. Sustainability remains a key component of our strategy, a core company value, and critical to our broader ESG program.

On Slide 8, we outline some of our 2023 sustainability initiatives, including the establishment of a Sustainability Council made up of company executives and leaders with direct oversight from our Board. We also embedded ESG into our long-term executive compensation program. Our ESG report for 2023 is in the final stages of development and expected to be issued in May 2024. To find out more, please visit the ESG section of our website.

Moving to Slide 9, earlier this month we announced that Brian Dewsnup has been appointed Executive Vice President and Chief Financial Officer of NFI Group, effective March 1, 2024. Brian joined NFI through our acquisition of North American Bus Industries, or NABI, in 2013, where he was the CFO.

Prior to his new position, Brian acted as the Head of Strategy, leading the due diligence and acquisition of MCI, and then went on to be the President of NFI Parts, where he played an instrumental role in consolidating numerous aftermarket businesses into one parts business, grew revenue, combined distribution facilities, improved margins, and lowered overall costs. Brian also led our ARBOC shuttle bus manufacturing business since 2022. We'll hear more from Brian later this morning.

I will now pass it over to Paul to walk us through the high level financial results for the fourth quarter.

Paul Soubry^ Thanks, Stephen. And good morning, everyone. I'm on Slide 11, and I'll provide a brief summary of the quarter. Starting first with demand, which remains strong with 143% sequential quarterly increase in new orders and a full year backlog book-to-bill ratio of 113%. The option backlog conversion rate also showed healthy recovery, now reaching 41% for the fiscal year of 2023.

Year-over-year bus and coach deliveries were up 19%. Quarterly revenue was up 15%, and Adjusted EBITDA was up 642%. Gross margins also recovered well, reaching 11%, reflecting a strong contribution from the aftermarket business and a seasonally strong quarter from the previous market.

Our aftermarket segment delivered yet another quarter of outperformance and its strongest year ever with $551 million of revenue and $120 million of Adjusted EBITDA. These results were primarily driven by increased aftermarket sales in North America, favorable product mix, and management of our freight cost and logistics. NFI's backlog remained very robust at US$7.9 billion with over 10,500 equivalent units.

The average selling price for vehicles in our backlog also increased by 22% year-over-year, reflecting a higher proportion of zero-emission vehicles and pricing actions that we've taken in contracts mid-2022 onwards to reflect the impacts of inflation and a changing product mix. We also ended the fourth quarter of 2023 with a very high number of equivalent units in bid award pending at a record 3,832 equivalent units, where we now await formal customer paperwork, which will position us for another period of backlog growth in 2024.

Slide 12 highlights the dramatic improvement in supplier performance, where the number of high and moderate-risk suppliers has continued to decline. We continue to experience some disruption from certain parts or components, but these are generally short-term delays of a few weeks related mostly to supplier labor availability at their facilities. We are keeping certain suppliers at our medium risk rating as even though their on-time delivery has improved significantly, and we do this to monitor their performance as they ramp up their production to meet our increased line entry rates.

Slide 13 shows our quarterly inventory balances and line entry rates. Working capital declined by $64 million in the quarter as we began to lower finished goods and work-in-process inventory. This was somewhat offset by higher raw material inventory balances that we put on hand to support stable supply and increase in receivables reflects the increased deliveries in the quarter. Our line entries were down slightly in the quarter, primarily the result of two holiday periods, which included U.S. Thanksgiving and the Christmas holiday break.

We project line entries will show improvement in 2024 as we continue to ramp up our production. The ramp-up will be a phased approach, as we have talked about consistently, over many years matching the supply of labor and supply availability from our customers' abilities to inspect and accept these vehicles. We are being measured as we ramp up to ensure that we do not see a buildup of offline buses or work-in-process as they generate significant rectification and interest costs.

I will now ask Pipasu to walk us through the highlights of our fourth quarter, our full year 2023 financial results, and after which Brian and I will provide some insights into our outlook. Over to you, Pipasu.

Pipasu Soni^ Thanks, Paul. Starting on Slide 14, our multi-year backlog remains strong at 10,586 EU, split almost equally between firm and option orders. Backlog options now extend out to 2028. Year-over-year we saw heavy-duty transit bus deliveries up 21% and coach deliveries up 20%. Low floor cutaway and medium-duty deliveries were essentially flat.

Turning to Slide 15, gross margins continued their positive progression reaching 32.1% in aftermarket and 6.6% in manufacturing. We anticipate the manufacturing margin improvement will continue as we ramp up operations and deliver the remaining legacy inflation-impacted contracts in the first half of 2024.

On Slide 16, we have provided a chart showing segmented Adjusted EBITDA dating back to 2019. You will see significant improvement in the fourth quarter of 2023 with consolidated Adjusted EBITDA exceeding expectations at $38.5 million, a nearly $46 million improvement from this time last year. Full year 2023, we delivered $69.2 million of Adjusted EBITDA, exceeding the high-end of our guidance of $65 million. Of note, the manufacturing segment delivered its first positive quarter since 2021, further highlighting our trajectory of recovery.

On Slide 17, free cash flow saw improvement in the quarter, finishing at $2.7 million, a 111% increase from the fourth quarter of 2022. The improvements came from increased cash from operating activities offset by an increase in interest paid, income taxes, and cash capital expenditures. When combined with changes from working capital, we generated $22 million in cash flow in the quarter.

On Slide 18, we provide additional key financial indicators. Our total liquidity ended at $188 million, up from $170 million as of the end of the third quarter of 2023, and up from $144 million at the end of 2022, with improvements driven by improved cash flows from operations. Working capital days also saw improvement sequentially and year-over-year as we worked to lower overall inventory balances.

For the remainder of fiscal 2024, we expect a slightly longer cash collection cycle due to the significant increase in ZEBs and resulting time required for customers' final inspection and acceptance once on their properties. On Slide 19, our net loss decreased by $150 million, primarily driven by higher deliveries, revenue, and Adjusted EBITDA offset by increases in interest, financing costs, a reconciliation of net loss to adjusted net loss is provided on the slide.

I will now turn the call back to Paul.

Paul Soubry^ Thanks, Pipasu. Picking up on Slide 21, we provide a summary of some of our key public demand metrics for North America.

Total active bids of over 8,700 equivalent units included 7,631 equivalent units in bids submitted and another 1,101 in bids in process. We anticipate these bids will lead to significant new awards when combined with the five-year customer outlook of 22,098 equivalent units supports our view that bus and coach demand will continue to remain very strong.

On Slide 22, we highlight NFI’s order and delivery activity for the quarter. As previously mentioned, we had new orders for 2,361 equivalent units in 2023 Q4, driving total orders of 6,121 equivalent units for the year. In addition, as I mentioned earlier, we had 3,832 equivalent units in bid award pending, many of which we expect will convert in the first quarter of this year.

On Slide 24, we provide a brief summary of the record government funding for each of the major markets to help drive ZEB demand for our market and for NFI.

On Slide 25, we provide an update on the changing competitive dynamics within North American market. In 2019, we had six key competitors and total market deliveries were 6,700 equivalent units. In 2023, one competitor filed for Chapter 1 [bankruptcy] with their assets subsequently acquired by a much smaller player, and another announced its exit from the U.S. heavy duty transit market in 2025. Early in 2024, a second competitor announced their exit from the business. These changes have led to a capacity decrease in the United States market and improvements to NFI’s overall competitive position. All players who exited the market referenced the difficulties of heightened inflation, supply disruption, and working capital requirements on their decisions to exit.

On Slide 26, we discussed the task force led by the American Public Transportation Association, or APTA, and the response by the Biden-Harris White House administration and the FTA, and their response to the significantly and seriously adverse impact on U.S. bus manufacturing capacity. In October of 2023, APTA with the support of the FTA, created a bus manufacturing task force to recommend immediate actions that can support competitive and stable bus manufacturing capacity in the United States. NFI has been a very active member of this task force, along with other manufacturers, suppliers, and many larger and medium sized U.S. transit agencies.

On February 7, 2024, I had the privilege of presenting at the White House Roundtable and we discussed key recommendations for immediate changes to the U.S. bus contracting scenarios, which include price adjustments for existing contracts to reflect inflationary impacts, the ability to make progress payments, then the use of price indices on firm contracts and incentives to minimize excessive customization.

The FTA has now issued a Dear Colleague letter to the U.S. transit agencies recommending that they adopt these changes in their existing and their new contracts. The FTA also informed agencies that going forward preference will be given on certain new grants to procurements that adopt these changes, very encouraging from an NFI perspective. These recommendations have the potential for a material impact on the economics of our business, primarily as it relates to working capital investments and the interest costs associated with the financing, our work and process.

Many U.S. transit agents have already responded positively to these recommendations and our customer-facing teams are actively engaged in a multipronged approach to negotiate relief in our current contracts, while also adopting these methodologies approach in active and future bids. We'll provide updates on the financial and operational impacts that these changes may have as they are implemented or take effect through the rest of this year.

I'd now like to pass the call over to Brian Dewsnup, who will provide a brief introduction to himself and some insights into our outlook. Brian?

Brian Dewsnup^ Thanks Paul. Good morning.

I want to start by commenting on my enthusiasm as I assumed NFI’s CFO role and continue to advance our operational and financial recovery. Having previously been a CFO at NABI and President of both NFI Parts and ARBOC, I feel my background, skill set and knowledge of the industry will help drive value across the finance function.

My initial areas of focus over the coming weeks will be getting acquainted with our investors and banking partners. Additionally, I'll be working with Paul and the business unit presidents to advance our financial recovery, working with the Board in assisting our capital structure, managing our liquidity with deliberate focus on improving our working capital management, and supporting our teams to achieve NFI's guidance and financial targets.

Turning to Slide 27, we are reaffirming our 2024 financial guidance and 2025 targets. For fiscal 2024, we anticipate double digit revenue growth, triple digit Adjusted EBITDA growth, and improved free cash flow. We will see an increase in capital expenditures as we catch up on maintenance and invest in growth projects.

We've adjusted our ZEB guidance metric to be ZEB deliveries as a percentage of total deliveries (as opposed to a percentage of manufacturing revenue). This makes the metric clear to understand, matches our executive long-term compensation metric, and is easier to calculate from our financial results. We anticipate ZEBs to be 30% to 35% of total deliveries in 2024, growing to over 40% in 2025.

We've also provided our 2025 targets, which include Adjusted EBITDA of greater than $350 million, and expect to reach a $400 million annualized run rate by the fourth quarter of 2025. The multiyear growth in our financial projections is driven by a combination of volume recovery, production efficiencies, improved product pricing, and an increased number of higher margin, zero-emission bus deliveries. We also anticipate that we will move beyond the majority of our legacy inflation impacted contracts after the first half of 2024.

Based on our guidance and working capital expectations, we do not anticipate significant debt repayments in 2024 as we ramp up production volumes. This could change depending on the progress of the FTA Dear Colleague letter, as Paul mentioned, has on bus manufacturing contract structures in the U.S. and our overall success in increasing customer deposits and milest1 billings.

We've maintained a ROIC target of greater than 12% for 2025 with potential for outperformance on this metric as we lower debt balances and see improvement in working capital investments.

Turning to Slide 28, we provide some directional commentary on the seasonality and the impacts of inflation impacted legacy contracts. In the first half of 2024, we expect to deliver approximately 35% of our Adjusted EBITDA, with 65% coming in the second half of the year. Sequentially, we expect a decrease in Adjusted EBITDA in the first quarter of 2024 as this is typically our slowest period in private markets and is also impacted by legacy contracts. As you can see in the chart, these legacy inflation-impacted contracts are expected to make up 9% of our first quarter deliveries and approximately 10% of total first half deliveries.

Finalizing delivery on these legacy contracts is expected to drive significant improvement in North American Transit contribution margins, with an expectation for a 30% increase starting to materialize in the second quarter of 2024, with the largest improvements expected in the third and fourth quarters of the year.

On Slide 29, we highlight the average price of each unit and our total backlog. This has increased for both heavy-duty buses, which is the dark blue line, and motor coaches, the light blue line since 2020, reflecting a combination of higher ZEB orders, inflation adjusted pricing and improved margins on our new contracts. This improved pricing environment supports our guidance on our 2025 targets.

I’ll now turn the call back over to Paul to close out before Q&A.

Paul Soubry^ Thanks, Brian.

And before we open the line to questions from our listeners, I want to thank and extend sincere gratitude to Pipasu for his active leadership and dedication as our CFO from 2020 through February of 2024.

Pipasu has played a critical role in supporting NFI's navigation through the COVID-19 pandemic and subsequent global supply chain crisis, culminating and leading the execution of a very comprehensive refinancing plan in 2023.

Pipasu, we wish you luck to you and your family, all the best as you return to the United States. Thank you for supporting the transition and handover of the CFO reins to Brian over the next couple of months.

With that now, [Michelle], I'll hand it over to you to provide instructions to our callers on how to ask questions.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) The first question comes from Tamy Chen with BMO Capital Markets. Your line is now open.

Tamy Chen^ Hi. Good morning. First, I had a question for how Q4 unfolded. The bus segment margin was quite strong, but I was surprised that your average selling price was lower than previous quarters. Just would have thought the pricing would be much stronger to generate that strong margin. Can you just explain that piece first?

Paul Soubry^ Thanks, Tamy. Zero-emission buses have better margins generally in terms of dollars, but not quite as strong in terms of percentages, that's one issue. The second issue is, depending on which buses were delivered in the fourth quarter, we still have some legacy-priced contracts that were moving through the system.

So that will have, in some cases, a lower selling price and then a lower margin. The third issue is that we had a high proportion of 60-foot buses running through the system in the fourth quarter of last year. And of course, a 60-foot bus takes up two production slots, but from an average sale price per EU is less. So, there's a lot of mix dynamic that's happening in the quarter.

Very pleased with the ultimate performance and recovery. We'll continue to see that kind of noise going forward, ICE versus zero-emission mix, and 40 versus 60 or double-deck type buses as we march through 2024 and 2025.

Tamy Chen^ So it sounds like a lot of these things in Q4 was a headwind on the selling price, but again, like the bus, margin was strong. So were there any reductions or efficiencies that you also benefited from in the quarter? I am just trying to square away the different pieces here.

Paul Soubry^ Well, as I've mentioned many times over the years, we don't spend a lot of time looking at average selling price other than as an indication of the size of the backlog. Depending on which buses got out of the system, depending on what our private versus public customers, MCI a very, very period in the fourth quarter which don't have a fairly large or don't have a significant compulsion of zero emission buses. We'll continue to see the average selling price move up. We saw it in 2023. We'll see it in 2024. And of course now we move into a world of differentially priced contracts with higher margins going forward and a much higher percentage of zero emission.

I wouldn't read too much into kind of efficiency or productivity gains more around mixed dynamics.

Tamy Chen^ Okay, fair enough. And my other question is, so for 2024, you're expecting from a volume perspective, 5,000 EUs, it's quite high. I don't know that you've historically done that. So can you talk about how you arrived to that number in the context of what's coming from North America transit? Is there a meaningful recovery you expect in the UK business? How about motor coach? And you've talked about how labor is still tight. There are still some pockets of supply chain issues. So just wondering if you feel you've baked enough conservatism or buffer in the guidance for that 5,000 EUs? Thanks.

Paul Soubry^ Thanks, Tamy. It's a good question. And of course, we've been through both volume compression and mix changes as we went through COVID-19 and then supply chain dynamics. Just for context, if you take the full year of 2019, of course, we only owned Alexander Dennis for roughly half of the year, but if you performed the full year, our business delivered about 6,200 equivalent units in 2019. That troughed all the way down in 2022, where we were just over 3,000 units. We did roughly 4,000 units last year and we're projecting roughly 5,000 units this year. And if you do the math, based on our forecasting and our volumes for 2025, that's roughly getting back to about 6,000 units in 2025.

I've been here 15 years now. I have never seen the production schedule, the number of slots that have been sold in advance, farther out than I've ever seen. From a New Flyer perspective, the vast majority of our slots, if not all of them, are already sold and assigned to a customer. From an Alexander Dennis perspective, the same thing all the way through third quarter and in the fourth quarter, we still have some open slots, but we have high probability customers in there.

Our ARBOC business effectively has every slot this year sold. Our MCI business, which is about two-thirds private and one-third public, has the vast majority of the public units sold and has a high win rate on the private units. So our confidence in delivering the 5,000 units this year is relatively high. The dynamic, and why we adjusted our guidance earlier in January, is we are cautious about labor availability and consistent part supply.

Our part suppliers are absolutely keeping up with us at this point in time, notwithstanding a few changes and challenges here and there. But, in 2024, we're not back yet to what we saw in the 2019 period. Our confidence, and given the competitive dynamics, given the funding environment, given the fleet replacement cycles of the customers, this is far more about execution focus, which we are gaining more and more confidence every day, than it is about worrying about selling slots.

Tamy Chen^ And why is it that when you did revise guidance for 2024 and 2025, the delta of the revision in 2025 was greater than 2024? If you're cautious on labor availability and part supply, that would presume maybe more of that impact is felt nearer term. So this year, and then it just improves next year. So would have thought the delta of the guidance revision would have had more negative trends in this year versus next year. That's it for me. Thank you.

Paul Soubry^ Well, look, Tamy, the way we work that guidance is we go literally plant by plant, slot by slot, customer by customer, and we know what we've sold, we know what our win rate is, we know what we're bidding on in those periods. We felt that the most prudent thing to do was to adjust the 2024 and 2025 targets, being cautious, knowing that we still have a delicate supply dynamic and a delicate labor environment, labor availability. In the NFI across the business for 2024, we don't have to add that many people. We went through a period of time where a few parts can hold up $1 million assets and they can pile up in our parking lots very quickly.

Our single biggest concern was that we don't want it to get into a scenario where we build product and we have buses offline waiting spare parts. The cost of rectification and the cost of working capital or interest on our working capital is so absorbent at this point in time. This is all about smoothing out the growth of the business.

There is upside in our 2024, there's upside in our 2025. But we felt it more prudent to provide our shareholders and our stakeholders with a confident, if you will, run rate through 2024 and 2025. The fact that we've had a number of competitors go away ultimately changes the dynamic again at our ability to win and our ability to actually fill production slots with much, much better, healthier margin product.

Tamy Chen^ Okay. Thank you.

Paul Soubry^ Thanks, Tamy.

Operator^ Please stand by for the next question. The next question comes from Cameron Doerksen with National Bank. Your line is open.

Cameron Doerksen^ Thanks. Good morning. I have a couple of questions on the potential impacts here from this Task Force. I mean, I appreciate, obviously, there's a lot of moving parts here, maybe it's kind of hard to predict what might happen from a cash flow perspective if some of these changes go through, which it does appear that they're going to.

I'm just wondering about the retroactive price adjustments. Obviously, that potentially would be positive for you on existing contracts. But it seems to me that maybe most of these sort of lower-priced contracts may already be delivered by the time some of these changes come through. I'm just wondering if you can comment on what potential positive impact might come from those price adjustments on existing contracts?

Paul Soubry^ Good morning, Cam. It's a really good question, and it's hard for us to explain in a couple paragraphs to our analysts, our investors, our listeners on the dynamic. The context is that the Washington is very frustrated with the FTA and the transit agencies by the approach relative to contracting and all the things we've been talking about for years. We don't get milestone payments, the very difficult nature of adjusting pricing when there's things like hyperinflation and so forth.

So, first and foremost, the guidance that came out of the government basically says now, as we submit proposals, there's no question that it's acceptable to government to have price indices to adjust for changes in economic conditions. There's no question about whether the FTA will accept milestone payments and all those other things. When it comes to our current and existing contracts, the vast majority of the stuff that is massively inflation-affected is coming through in the first and part of the second quarter of this year.

There are still, however, some that we have the potential to readjust the pricing. However, nobody is mandated to do that. What this allows us to do now is have a clear roadmap to go back to those customers and try and negotiate. But to get that, there must be consideration. And, so, we're going to be asking customers for price adjustments where we have been still hurt by certain costing elements. We are going to be asking customers for improved payments and milestone terms. And to do so, we're going to have to find a way to incent them, whether that be discounting on pricing, whether it be additional warranty coverage, whether it be parts, credits and all those other things.

So we are mildly excited about the impact on 2024 relative to any of those adjustments to existing contracts. We are very encouraged as we move through 2024, 2025 and 2026, that we are actively biding the vast majority of contracts with price adjustment clauses in there and with milestone payments embedded in our proposals. We just want to temper people's expectations, not to see step change in margin or cash flow in 2024. But as we move through 2025 and 2026, we expect a very different cash profile of our business.

Cameron Doerksen^ Okay. That's very helpful. And I guess sort of related to the Task Force. I mean, it does appear that one of the goals here in making some of these changes is to perhaps encourage additional competition. Obviously, there's sort of a duopoly situation now in the U.S. I wanted to get your thoughts around the potential for new competition to come in, obviously, not a near-term impact. But I guess one of the things that was proposed in the Task Force was having some sort of a bridge to Buy America-compliance; doesn't sound like there was any resolution on that, but just your thoughts around that, as well.

Paul Soubry^ The Task Force is chaired by the CEO of New York City Transit and the CEO of Chicago Transit Authority. Both were customers of one of the competitors that have exited the U.S. market. In many cases, we find ourselves as a sole bidder today, or potentially two bidders, as you alluded to earlier. We do expect to see competitors coming to North America. We do expect a recovery of the overall market size. It will take time for those customers if they, for example, have a European bus designed to metric standards and tested to European standards to get domestic supply, to get domestic to move it and convert it into imperial designs and steel sourcing and all that other stuff.

The proposal by one of the persons on the Task Force of allowing a honeymoon or a holiday for some of these international players to come to the United States is completely in contravention to what the U.S. government's desire is for domestic capability. So that never made it into the recommendations. What it is was a concept or thought floated by one of the transit agencies.

Never say never, but I would be really surprised to see the U.S. government and whoever is in the administration allowing imports of vehicles that don't have the U.S. domestic capabilities, supply chain or any of those other things, which is also part of our strategy. We've beefed up over the years the amount of product that we've actually built physically in the United States and are in complete compliance. The focus was far more on price adjustment methodologies and working capital managing of the supply in relation to milestone payments for companies like us to finance the work in process. I don't see some of those outlier type recommendations making much progress.

Cameron Doerksen^ Okay. No. That's really helpful context. Appreciate the time. Thanks very much.

Paul Soubry^ Thanks, Cam.

Operator^ Please stand by for the next question.

Next question comes from Krista Friesen with CIBC. Your line is open.

Krista Friesen^ Hi, thanks for taking my question and just want to say good luck to Pipasu and congrats, Brian on the new appointment.

I was just wondering, regarding Germany, they're cutting their subsidy now for EV buses in part due to the strong demand, and they don't feel the need for the subsidy anymore. Are you seeing or hearing anything like that?

Paul Soubry^ Sorry, could you just – we missed the very beginning when you said was cutting the subsidy.

Krista Friesen^ Oh, sorry. Germany announced they're cutting some subsidies for EV transit buses, city buses, and just wondering if you're seeing this elsewhere or hearing this and just how you think of that potential eventuality, maybe in some of your larger markets.

Paul Soubry^ Thanks, Krista.

So, first of all, we historically only sold diesel double-deckers into Germany. The markets of which we're prominently playing in: Canada, the United States, all parts of the United Kingdom, Hong Kong, New Zealand, and so forth. The amount of money, the amount of focus, the amount of incentivization and push from the government to continue to convert their fleets from ICE to zero emission, in our opinion, and our view in fact has not backed off at all.

We watch very carefully parallel markets like automotive, where demand and so forth may be changing. The OEMs may be pulling back at the pace of pushing zero emission. But quite frankly governments are using zero-emission buses as public policy to push an industry in which they heavily subsidize anyway moving in that direction.

I would have said, quite frankly, the amount of money we're seeing in our core markets is advancing as opposed to retracting. Not really familiar with Germany's position on the bus dynamic. When we look at the number of units that we have either in backlog, in Bid Award Pending or the RFPs that we have on the street, those numbers are only increasing. In fact, 50% of the Bid Universe, these are bids that are either active or projected from our customers, today is zero emission.

Five or seven years ago, that was 10% or 15%. So we're seeing, quite frankly, the inverse of the way maybe Germany is taking an approach. The other reality is that zero-emission adoption is not a revolution. When you look at a city like New York that's got 6,000 buses or Chicago 3,000, those are not going to flip to zero-emission overnight. It is an evolutionary story, and so we're seeing more and more movement and progression towards that.

The pace of the curve may change, but we don't see any retraction from that stuff. And, long-term, we get lots of questions about whether the White House is controlled by the Republicans or the Democrats or whatever. What happens with the Congress? Quite frankly, what we've seen over the last ten years is the migration to push more public transit into the cities in North America has really been a bipartisan dynamic, right? They're making big investments in zero emission in the United States, and we're a beneficiary of that progression.

Krista Friesen^ Okay. Great. Thank you.

And then just switching gears on the aftermarkets business, that's obviously been quite strong. Both top line and even the gross margin kind of just continued to grind higher here. How much higher do you think gross margin for aftermarkets can go? And was 2023 kind of a standout year that maybe we should expect a little bit of normalization, or at least maybe not as much growth in 2024?

Paul Soubry^ Well, I appreciate you calling it out. I think Brian's team has done a miraculous job, as has the team over at Alexander Dennis historically. The overall kind of summary speech of aftermarket parts is as follows. We at NFI have put together a roster of businesses, New Flyer, MCI, the Orion parts business, NABI, and so forth.

What Brian's been able to do is effectively bring all of those brands and all of those individual warehouses under one team, significantly rationalized the overhead cost of running that distribution business, but also navigate it through COVID-19 with freight increases and fuel surcharges and so forth. So a big lift on the [Adjusted] EBITDA and cash flow coming out of the parts business has to do with the operational efficiency that has been generated.

The second issue is that we saw as fleets went through COVID-19 and came through the supply chain crises, demand for spare parts because they weren't replenishing their new buses as fast as possible has gone up. And Brian has been very careful and conscious about supplying to customers for both replenishing their parts on the shelf, but also delivering to buses that are in service that require immediate parts.

So, from a margin perspective, a lot of it is dynamically priced. Compare the parts business to the OEM business; in the OEM world, you have a bid that is done, and then 300 or 400 days later we make the bus. In the parts world, if Brian's team gets a price increase, we're able to dynamically price increase for the vast majority of those parts customers. So we're not absorbing inflation dynamics for longer periods of time.

I would suggest that the parts business has room to continue to grow in size and mix. We're trying to make some strategic decisions about how we do that.

I wouldn't expect the margin percentages to go higher in those businesses. There's a balance obviously in terms of continuing to support the customers, but also doing it at a fair and economic return.

So that's, Brian, I don't know if anything you'd want to add. You've been running this business. Any colour you want to add to that discussion?

Brian Dewsnup^ Yes. I think that's right. I think with the amount of uncertainty that was in the marketplace with the higher inflation and the transportation and logistics costs, we, as you mentioned, were able to price that into our product and as we saw diesel-fuel surcharges decrease and some other changes we've made to the business that allowed for some margin expansion. But I don't know that it's going to go much higher than where it is today.

Krista Friesen^ Okay, thanks. That's great colour.

Paul Soubry^ Thanks, Krista.

Pipasu Soni^ Thanks, Krista.

Operator^ One moment for the next question.

Next question comes from Daryl Young with Stifel. Your line is open.

Daryl Young^ Hi. Good morning, everyone.

Paul Soubry^ Hi, Daryl.

Daryl Young^ Just a quick one here on the liquidity and the balance sheet and the expectations for working capital ramp-up across the first part of the year. It looks like you've made a few changes to lower the interest rate subsequent to year end and maybe some changes to the EDC credit. But how are you're feeling about the first half of the year and maybe the magnitude of the working capital investments?

Paul Soubry^ Well, it's a really important question, and it's topical, Daryl. We spend all of our time right now trying to manage the whole liquidity dynamic as we ramp up the business. So, first and foremost, we did an interest rate swap in the first quarter. So that'll help hopefully mitigate or manage the interest costs. Zero-emission buses, as we ramp-up, require higher, more expensive dollars. So we're replacing certain units that are moving through the system with more expensive ones.

Alexander Dennis is now building electric vehicles, electric buses with their own chassis and therefore their own battery and electric power plant supply.

Before, in many cases, we'd have an electric chassis delivered to us by BYD that didn't sit into our working capital. So, as we reduce overall work-in-process and move it through the system faster, we're replacing that with effectively more operating working capital inside the business.

We kind of chose our words carefully, but, quite frankly, the benefits of reduction of offline WIP or the reduction of working capital inside the business is being replaced with working capital as we ramp up the business. So, while overall free cash flow positive in 2024, but it doesn't significantly reduce our debt. And of course, it's a back-end loaded business; as we grow our business this year, we'll deliver more in the back half as well.

But we're really, really pleased with the pace at which we're getting buses through the system. The number of offline buses is dramatically down. The number of buses that we call out-of-station hours, where we go to build a bus and it doesn't have the parts and stations, so we have to catch up either downstream or offline is noticeably different.

I think what you're going to see is volatile liquidity through the rest of this year, improving liquidity in the back half of this year, and then substantially improving liquidity as we move through 2025 and 2026.

Daryl Young^ Okay. Great. That's it for me. Thanks very much, guys.

Paul Soubry^ Thanks, Daryl.

Operator^ I show no further questions from the phone lines at this time. I will turn it back to Stephen if we have any questions from the webcast.

Stephen King^ Not seeing any questions from the webcast.

So I think we will wrap it up, [Michelle].

Thanks everyone, for joining us on today's call. As always, please visit the Investor section of our website for any additional information. And never hesitate to reach out to us and our team here on the IR side with any questions.

Thanks, and have a great day.

Operator^ This concludes today's conference call. Thank you for your participation.

You may now disconnect.