NFI Group (Q4 & Fiscal Year 2022 Financial Results)

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Corporate Speakers:

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

Participants:

- Christopher Murray; ATB Capital Markets Inc.; Research Division, MD of Institutional Equity Research for Diversified Industries & Senior Analyst
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- Daryl Young; TD Securities Equity Research; Mining Research Associate

PRESENTATION

Operator^ Good day, and thank you for standing by. Welcome to the NFI 2022 Fourth Quarter and Full-Year Financial Results Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. I would now like to hand the conference over to today's speaker, Stephen King, Vice President of 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 2022 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.

We will start today's meeting by delivering a land acknowledgment, also known as a territorial acknowledgment.

I acknowledge that I reside, and that NFI is Headquartered, in Treaty One Territory, the original lands of the Anishinaabe, Cree, Oji-Cree, Dakota, Lakota, Dene Peoples, and the birthplace and homeland of the Metis nation. We respect and give honour to the Indigenous peoples' history on this land and recognize First Nations, Metis, and Inuit peoples' ongoing contribution in our neighbourhoods and communities.
We acknowledge our relationship with Indigenous people in Canada and throughout the world—a unique relationship that is committed to truth and reconciliation.

Today's call will be a little longer than our usual quarterly calls, with approximately 45 minutes of presentation, followed by Q&A. We want to provide a detailed update to our investors and stakeholders, so today we will discuss how we finished 2022, provide information on the record bid and funding environment, an update on supply chain, and on our longer-term outlook and anticipated financial recovery.

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

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. You are advised to review the Risk Factors found in NFI's press releases and other public filings on SEDAR for more details.

One item to note is that in order to allow our external auditors to complete their final normal course audit procedures the audited financial statements are expected to be filed on SEDAR and the Company's website by the end of this week. NFI does not anticipate there will be any changes between the information included within our press release, presentation or MD&A and the final audited statements.

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 both production slots and delivery statistics. The majority of our vehicles represent 1 equivalent unit, while an articulated 60-foot transit bus takes two production slots and is therefore equal to 2 equivalent units.

On Slide 4, for those of you new to the NFI story, we'd like to provide background over the next few slides. With over 450 years of combined experience, we are a leading independent global provider of sustainable bus and coach solutions. We are leaders in our core markets, which includes North American heavy-duty transit, coach and aftermarket, UK heavy-duty transit and aftermarket and the world leader in double deck transit buses.

On Slide 5, we outline the evolution of our offering and the ecosystem that we offer our customers and partners. At our core are our vehicles, complex and customized for mass transportation. They are supported by industry-leading aftermarket parts and service. We pride ourselves on being thought leaders in our space and drivers of workforce development and training – with special focus on creating opportunities for a diverse, equitable and inclusive workforce. With the evolution of new technology, including battery- and fuel-cell electric propulsion, we've seen increased demand for our connected vehicle technology, including telematics and diagnostics, autonomous or advanced driver assistance systems, vehicle financing, and infrastructure support. Our Infrastructure Solutions business works directly with customers to assist them in determining needs and commissioning electric vehicle infrastructure a business that has installed over 340 chargers with more than 58 megawatts of capacity.

Turning to Slide 6: Our stakeholders, presented in the wheel on the left, drive our strategic and organizational decisions and our values are at the core of our operations. We concentrate on achieving a balance and delivering for all our stakeholders and this wheel was especially helpful as we made difficult decisions during the COVID-19 pandemic and associated supply disruption.

On Slide 7: We provide a brief snapshot of our history, including the numerous acquisitions that have built NFI Group. As you can see, on a pro-forma basis we were nearly a $3.2 billion dollar revenue business in 2019. The past few years have been challenging due first to the COVID-19 pandemic, followed by global supply disruption, both impacting our delivery volumes, but we envision that we will exceed our pre-pandemic levels with a target to deliver approximately $4 billion of revenue by 2025. This view is supported by the expected benefits of increased demand, higher ZEB sales and international expansion. Items we will discuss in detail this morning.

Slide 8 provides information on the diversification of our business. North America remains our largest market, but we have seen significant expansion of our international business in both the UK and Europe, plus contribution from Asia Pacific regions, all driven by our 2019 acquisition of Alexander Dennis. Heavy-duty transit in both North America and the UK remain our largest product segments, with the majority of those sales going to public entities or entities that receive funding from public governments. Aftermarket businesses, both in North America and internationally, are also critically important as drivers of revenue and significant margin performance over the past three years. Finally, as you'll hear numerous times throughout this morning's call, we are seeing continued and rapid growth in the demand for ZEBs, with a higher portion of revenue coming from these electric vehicles, which is expected to grow significantly in the near- and long-term.

This transition to electric vehicles, what we call the ***ZE***volution, is exciting for NFI as we are leaders in the space. Slide 9 provides statistics on our capabilities and performance in ZEBs. The more than 2,725 electric vehicles we've delivered since 2015 have completed over 100 million electric service miles in 120 cities across six countries. Finally, as I mentioned previously, demand for electric vehicles is accelerating. In our North American Bid Universe, 51% of anticipated customer purchases over the next five years are for electric vehicles – when I started with NFI in 2018, this was just 18%.

Putting all of this together on Slide 10 is NFI's investment rationale. As discussed, we have leadership positions in attractive markets that are transitioning to electrification with record bid demand and government funding tailwinds. We expect this will grow both topline revenue and bottom-line earnings as our business drives significant earnings volume leverage. We have decades of experience and track record, which is critical to our customers and a key differentiator when compared to new market entrants. While we are leaders in zero-emission battery- and fuel cell-electric propulsion; we are propulsion agnostic, also offering legacy diesel, CNG, and diesel hybrid-electric options. We can support our customers throughout the transition to zero-emission as our facilities have propulsion agnostic product lines. This is another key differentiator from many of our competitors.

Finally, while there have been challenges over the past few years, we anticipate significant financial recovery with growth and potential outperformance relative to our peers and industry standards as we move through 2023 and into 2024 and 2025.
I'll now pass it over to Paul and Pipasu who will discuss all of these factors in detail, and recap the four quarter and Fiscal 2022.

Paul Soubry^ Thanks Stephen, and good morning, everyone.

I'll begin on Slide 12 with a summary of Fiscal 2022. We saw record demand for our products and services, juxtaposed with continued supply chain disruption, associated production inefficiencies, and the impacts of inflation and rapid foreign exchange movements. Our financial results reflect those realities, with declines in certain performance metrics, paired with outperformance in growth metrics. The Aftermarket segment was also a significant bright spot in 2022, delivering profitability while navigating through supply challenges.

A few highlights from the quarter:

- Strong growth in active procurements, up 54% year-over-year.
- Our highest new order performance since 2017 with over 5,700 EUs (a 23% increase year-over-year). This was the second highest level of annual orders in the past 16 years.
- Grew backlog by 9% year-over-year, finishing at $5.6 billion with a book-to-bill ratio of 134% for fiscal 2022;
- Zero-emission buses made up 23% of our full-year deliveries, up from 18% in 2021, and a record 29% of our backlog.
- We achieved milestones of more than 100 million zero-emission miles driven (a 100% increase from 2021); and;
- 51% of our total North American Bid Universe is zero-emission buses; this represents over 3,100 units a year over the five year outlook, supporting our view for a significant increase in demand for electric buses going forward;
- We achieved our target of $67 million of NFI Forward savings and $75 million when combined with cash flow savings – hitting our target in 2022; one-year earlier than anticipated;
- We completed two amendments to our credit agreements and subsequent to year-end entered into new loan agreements with the Government of Manitoba and Export Development Canada, which Pipasu will discuss in detail later this morning;

- Finally, even in the face of pandemic and supply chain-related challenges, we saw quarterly Aftermarket revenue increase 2% and generate a solid 17.9% Adjusted EBITDA margin – even with one less week of operations during a 52-week financial year versus 53 weeks in 2021 .

On Slide 13 and 14, we provide graphs that tell the story of supply disruption and the inefficiencies they created. First, on Slide 13 are our supplier risk ratings. This data is compiled from a detailed risk assessment process that monitors and evaluates the risk and potential impact of Supplier disruption. To do this, we review a supplier's financial strength, monitor past performance, and work proactively to understand tiered supply and other risk factors. We categorize suppliers based on these risks and consider severe impact suppliers as those who can result in line shutdowns, lower production rates, or significantly impact bus completion. We navigated through 2020 and started 2021 without major disruption from any severe impact suppliers. Basically, a similar performance to what our supply chain had delivered for years. In late 2021, this turned, with 50 high risk suppliers across NFI. This impacted key components such as windows, air conditioning units, emission systems, plastics, hoses and key electrical components, which contain micro-processors. While we saw improvement during the second quarter of 2022, critical electrical components remained a significant challenge, with some additional challenges arising in the third and fourth quarters of 2022 from wire harnesses, electrical hybrid drive systems and inverters for electric buses.

These disruptions inform the graph on Slide 14. These are our quarterly vehicle line entry rates, or otherwise stated the number of new vehicle builds that we start in our production facilities each week and quarterly WIP dollar investments. Line entries should be in the 1,500 units a quarter range, similar to 2019. Reductions in 2020 and 2021, were driven by the pandemic, then supply disruption. This was worse in 2022, with line entries hitting a low of 714 units in 2022 Q4. This data shows that our facilities were inefficient, and our teams were frustrated as they could build partially completed vehicles, growing WIP of buses and coaches missing certain components. The good news is that in the fourth quarter while we line entered fewer vehicles we completed and delivered many vehicles missing components, lowering WIP by $127 million dollars.

We have not sat idly by as we dealt with the supply challenges. Slide 15 we outline our proactive responses.

- To help offset the impacts of inflation and working capital investments, we sought out pricing adjustments and customer deposits or prepayments wherever possible. We have had significant success in both areas.
- We lowered our production line-entry rates (and staff levels) to better match production with demand and focus on WIP reduction.
- We found alternative suppliers – in some cases going down four levels in our supply chain to find alternatives for our suppliers.
- We increased our inventory of raw material components to improve parts availability where possible. For certain components moving from 6 days of just-in-time inventory to 15+ days.

- We increased our lead times to suppliers – what was typically 6 to 8 weeks has been increased to 10 to 12 weeks for many components and even longer for others – a huge lift for our engineering and supply teams working on customized vehicles.
- Finally, we continued to drive our cost reduction efforts. Since 2020, NFI forward has achieved $67 million of annualized cost savings. This required that we reduce over 2,000 positions across our organization and closed 25 facilities.

These were extremely difficult people decisions that impacted our teams. We defend our decision not to cut deeper, as if we were to shutter additional facilities or do even more significant layoffs, there is a high likelihood that we would not be able to recruit the staffing levels required for our recovery. We also would not have been able to deliver significant new order wins and backlog growth.

With those details in mind, I'll now ask Pipasu to dive into details on financial results before I provide an update on our outlook and guidance.

Pipasu Soni^ Thanks, Paul.

Picking up on Slide 16, we outline the backlog growth Paul discussed. With 4,576 EUs of firm orders, we have essentially sold out our 2023 production slots in North American and UK Transit, plus cutaways with good visibility into 2024. We also have options out to 2027 providing significant visibility for future years.

Quarterly and full year deliveries were down within Heavy-Duty Transit and Motor Coach, reflecting supply disruption. Cutaway sales were up in the quarter and a bright spot was higher average sales prices across all segments as we started to see more inflation adjusted contracts flow through our facilities.

On Slide 17, we provide several key financial indicators. Adjusted EBITDA was down in the quarter, and for the full year, reflecting lower delivery volumes, product mix, production inefficiencies and the impact of inflation on certain legacy contracts. Free Cash Flow decreased driven by lower Adjusted EBITDA, higher cash interest and higher cash capital expenditures and leases.

We were able to come in higher than we anticipated on liquidity achieving a year-end liquidity position of $173 million versus our target of $100 million, primarily driven by inventory unwind. While liquidity is down year-over-year, this is a combination of lower capacity under our amendments (a $262 million reduction), and the fact that, in November 2021, we completed an equity raise and convertible debenture issuance making for a tough comparison period.

Turning to Slide 18, we provide a year-over-year Adjusted EBITDA bridge. Several broad events impacted our 2022 results:

- lower volumes

- the fact that we did not receive government grants in 2022 versus the $56 million received in 2021
- pricing surcharges and inflation; and
- the impact of inefficiencies

We do not anticipate these items will repeat at the same level in 2023 and beyond. Slide 19 shows our gross margins by quarter from 2019 to 2022. Aftermarket recovered well from the pandemic, but saw some pressure in 2022 due to inflation and freight impacts. Manufacturing margins reflect inefficiencies and heighted inflation. This started significantly in the third quarter of 2021, and we believe hit bottom in the second quarter of 2022, with some improvements to finish the year. This is a positive sign as we anticipate significant improvement as we move into 2023.

On Slide 20, we outline the impacts to our Net Loss and Adjusted Net Loss. Our Net Loss for the quarter increased significantly driven by goodwill impairment charges from the Alexander Dennis Manufacturing and ARBOC cash generating units. These impairment charges came from increases in interest rates impacting discount rates and timing of our anticipated recovery shifting from 2022 and 2023, into 2024 and 2025. We normalize for this charge, plus mark-to-market adjustments on our interest rate swaps and other non-recurring items.

I'll now provide an update on our credit amendments and the ongoing discussions to secure a new multi-year credit agreement. On Slide 22, we provide details on the amendment that was completed on December 29, 2022, providing a covenant waiver until June 30, 2023. The table provides the covenants that are in place during this waiver period. In January 2023 we were able to secure new loans with the Government of Manitoba and EDC that provided an additional $87 million in proceeds, plus a new $100 million surety bonding facility. Photos of the announcement event held with representatives from the Government of Manitoba and the Federal Government of Canada are on Slide 23.

Turning to Slide 24, we provide our view on the timeline to execute new credit agreements. NFI will be seeking multi-year agreements that provide capacity, flexibility and covenants matched to our anticipated financial performance and recovery. We are targeting completion prior to June 30, 2023. We have completed the first three steps in the process and are in detailed discussions with our banking partners to advance the new agreements.

On Slide 25, we summarize our capital allocation priorities. While we work to complete new agreements, we remain focused on cash management, liquidity and strengthening our balance sheet. Proceeds from the Manitoba Facility and the EDC Facility received in January 2023 will provide additional liquidity, as will the continuing unwind of working capital primarily related to investments in WIP and raw material inventory. While there will be benefits from the inventory unwind, they will be somewhat offset by the impacts of lower deferred revenue where we received customer prepayments and deposits in 2022. In total, we anticipate that we will see a net inflow of cash from working capital in

2023, mostly in the first half of 2023. Additional inflows will be dependent on other advances and prepayments received from customers.

We are exploring other potential opportunities to generate cash flows, including capital markets activities, and potential sale and leaseback of select Company manufacturing facilities.

On this front, we have issued a shelf prospectus that would allow for a capital market transaction in a more efficient manner, should we choose to pursue those options.
I'll now turn the call over to Paul to discuss our Outlook and Financial Guidance.

Paul Soubry ^ Thanks, Pipasu.

Picking up on Slide 27, NFI plays a critical role in public transportation, which acts as a spinal cord for cities decreasing congestion, increasing access and more equitable outcomes, all while lowering emissions.

Turning to Slide 28: This was on display when US Vice President Kamala Harris and Nuria Fernandez, Administrator of the Federal Transit Administration, recently visited our St. Cloud facility.

It was a special event that rallied our team and placed significant focus on NFI's role. In the words of VP Harris, "You're not just building better buses, you're building a better America and are key to the future of public transportation." I can't think of a better endorsement and relevant words as we speak on our outlook!

I'm now on Slide 29. At our January 2021 Investor Day and last year during our fourth quarter results call, we mentioned several actions and milestones that would drive our future performance. On this slide, we highlight what has happened since that time and the numerous positives that have been achieved, even in a difficult operating environment, that help strengthen our view for 2023 and beyond.

We will maintain new vehicle production rates at lower levels through the first half of 2023 as supply chains aren't fully healthy, but improving. We anticipate that we will ramp-up production in the second half of the year.

We anticipate that the strong bid environment will continue as we have over 10,500 EUs in active bids currently in the market and a growing bid universe, driven by government funding.

Finally, NFI has completed the majority of its legacy contracts bid in 2020 and 2021 that are impacted by heightened inflation. Some depressed margin contracts will be included in our 2023 results, but these made up less than 20% of NFI's firm backlog and we expect they will be fully completed by the end of 2023.

I'll now explain some of the drivers for our longer-term outlook. On Slide 31, we provide our active bids universe and orders. As you can see following a period of depressed bids in 2020, we have seen a consistent increase in bid activity through 2021 and 2022 that has converted into orders. On Slide 32, we highlight our impressive 2022, the highest number of new orders since 2017 for 5,786 EUs. This is the second highest year of new orders in the past 16 years. These were also many multi-year orders from major Canadian and U.S. customers and significant ZEB orders from customers in the United Kingdom and Hong Kong.

On Slide 33, we show that these orders drove our book-to-bill to 134%, the second year that we were above 100%. While some of this performance came from lower deliveries, our strong order book provided the majority of this book-to-bill growth. Order conversions were down in 2022 as some customers allowed older options to expire as they focused on new ZEB technology.

Slide 34 provides the five-year outlook from our North American Bid Universe along with active bids. As you can see on the chart in addition to active bids, the five-year outlook for procurements has another 20,000 units providing a total bid universe of over 30,000 units. This supports our view that vehicle demand will continue to be at high levels going forward.

Turning to Slide 35, We show that we are the leaders in ZEBs in North America, the UK and New Zealand, with electric vehicles in service or on order with 17 of the top 25 transit agencies in North America and all five of the largest operators in the UK, plus additional units on order in Hong Kong. We have completed pilot programs for many of these large customers who are now moving into larger multi-year ZEB orders. We expect this transition will benefit NFI for years to come.

While we are leading the space, we aren't complacent. On Slide 36, we highlight just some of the advancements we made in our 2022 bus strategy with the launch of three new electric vehicle models, following the launch of six new models in 2021. As we move into 2023, we will roll out our new battery platform for North America, continue to advance the game changing Alexander Dennis' E100EV bus platform, and secure additional contracts for Alexander Dennis' future-proof, next generation battery program. This is a radical step up for Alexander Dennis that is expected to drive significant orders and activity out to 2025 and beyond. All very exciting advancements on our ZEvolution. I'll note that, as we discuss battery programs, we have strategically chosen to be smart buyers of technology and supplier agnostic on our battery cell and modules, given the need to be agile with rapidly changing technology.

We are experts at integrating electric propulsion systems into overall vehicle systems. This is not an easy task, and it supports our customers providing them with confidence and stronger performance. Going forward, we expect that our continued focus on being value creators in the battery pack and integration space will create margin enhancement opportunities for NFI as we deliver higher volumes of zero-emission vehicles.

Turning to Slide 37, we are in an environment of record government investments in public transportation within all our core end markets which is driving the heightened bid environment.

Looking first at the U.S., the landmark $1 trillion Infrastructure Investment and Jobs Act, or IIJA, is the successor to the historic FAST Act, and is the main funding mechanism used by U.S. transit agencies for new vehicle purchases. It generally provides 80% of the capital for a new vehicle and can provide 100% under certain programs.

As you see on the chart, the IIJA provides 64% higher funding than the FAST Act, and much higher funding levels than older programs. This reflects the higher costs of zero-emission vehicles and associated infrastructure. In addition, certain specific bus programs have seen massive funding increases, this was on display in the Low or No Emission Grant Program, which has grown from $180 million under the FAST Act to over $1.1 billion under the IIJA. NFI has been a significant beneficiary from the Low-No program.

In 2022, New Flyer supported the successful applications for almost $200 million in grants awarded to 15 U.S. public transit agencies. In January 2023, the FTA announced that there will be another $1.2 billion in Low-No program support for 2023. This is important as many of the grants awarded in 2022 have not yet resulted in firm contracts, so the Low-No program is expected to generate contracts for NFI for years to come. The IIJA has already started to drive significant order activity and is the primary factor that supports our view that the market will recover to deliver between 6,000 and 6,500 units per year, as we move through the funding period, with a higher percentage coming from higher margin battery- and fuel cell-electric buses.

On Slide 38, we look at Canadian funding, which is also record in size and scale. There are commitments to replace 5,000 ICE buses with zero-emission, through dedicated annual funding, and specific funding through the Canadian Infrastructure Bank. We have seen announcements for new programs in Edmonton, Ottawa, Brampton, and Calgary through the CIB. In addition, there was a tri-level government funding announcement for investments of over $500 million into the Winnipeg Transit system. We were proud to be selected as Winnipeg's partner on their first battery-electric vehicle order for up to 174 EUs announced in January 2023.

Canada has historically been a strong market for NFI, and we see tremendous opportunity for growth through the major investments being made by federal, provincial, and municipal governments.

Finally, on Slide 39, we provide an outlook on the UK market, where governments have also made significant commitments with a goal of putting 4,000 new UK-built zero-emission buses into service. While the pandemic and changes in leadership have slowed the timing of announcements and funding, we have seen initial distributions through ZEB specific programs, supporting orders for about 355 units for Alexander Dennis.

In 2022, the UK government continued to solidify their commitment to invest in improvements to bus transportation with an announcement that £7 billion would be invested to overhaul and level up major local transport schemes in 31 counties and city regions outside of London. This should be another significant win for our industry. UK vehicle deliveries were low prior to the pandemic, as operators waited on the roll-out of government funding for electric vehicles. Delivery levels will be somewhat muted in 2023, before seeing growth through 2024 and 2025. We expect a larger percentage of these vehicles will be battery- and fuel cell-electric, creating an opportunity for higher revenue, gross margin, and Adjusted EBITDA.

In addition to the UK, Alexander Dennis continues to grow its ZEB presence in Hong Kong and New Zealand – and is also pursuing exciting opportunities in other international jurisdictions that are expected to help grow our business as we head into 2025.

I'll know turn the call back to Pipasu to tie all of these macro environment factors to our financial guidance and targets.

Pipasu Soni ^ Thanks Paul.

I'm picking up on Slide 40. I'll walk us through our multi-year financial guidance and the critical drivers.

- Fiscal 2023 is viewed as a transition year. There will be growth from 2022, but we will operate at lower production levels in the first half of 2023, prior to ramp up in the second half. Exiting 2023 at higher production levels will benefit 2024 and 2025. Our past experience shows that increased efficiency and volumes drive margin enhancement – this was apparent in our results in 2015 through 2018.
- As discussed, certain legacy inflation impacted contracts are being delivered in 2023. We anticipate that contracts in 2024 and 2025 are appropriately priced matching with higher supply input and wage costs.
- We anticipate strong growth in ZEB sales based on backlog and expected new orders;
- We expect increased industry deliveries in North America and the UK driven by government funding in 2024 and 2025;
- We have and expect we will continue to see the benefits of NFI Forward throughout the period somewhat offset by inflation;
- Increased capex spending in 2024 and 2025 following lower periods in 2021, 2022 and 2023.

Putting all this together, you can see in the table that we anticipate Adjusted EBITDA of $30 to $60 million in 2023, followed by a significant increase to $250 to $300 million in 2024 (driven by production and volume recovery), and a revised 2025 target of approximately $400 million.

We have revised our targets for 2025 down slightly, mostly a function of the impacts from supply disruption and inflation in 2021 and 2022 being longer and deeper than what we could have foreseen when we originally set these goals. We are still extremely confident that we can achieve our target, with expectations that we'll exceed $400 million in Adjusted EBITDA as we get into 2026.

We've also maintained our ROIC target of greater than 12% for 2025, with potential for significant outperformance on this metric as we delever our balance sheet and see improvements in working capital investments.

Slides 41 and 42 provide statistics and metrics that support the assumptions I mentioned above. On Slide 41, you can see that ZEBs as a percentage of our total deliveries have been increasing rapidly, going from 8% in 2020 to 23% in 2022, with expectations for additional growth in 2023 and beyond. ZEBs as a percentage of our backlog have also been growing quickly, doubling in size from 2021 to 2022.

Slide 42 highlights that our backlog pricing is also up significantly – with heavy-duty backlog average unit prices up 26% since the beginning of 2021 and coach pricing up 11% since that time. This reflects a combination of higher ZEB orders plus inflation adjusted pricing being reflected in our new contracts.

Turning to Slide 43, we want to make it clear that, while these targets may seem aspirational, as we look at our pre-pandemic results it is not a long road to $400 million of Adjusted EBITDA. The bridge shows that the majority of our growth comes from volume and mix. As we've discussed throughout this morning's call, the funding environment, bid activity, increased demand for ZEBs, and our existing backlog (with options to 2027) support our views for these benefits. In addition, we've already achieved our NFI Forward targeted savings of $67 million, with potential for additional benefits from a few smaller projects under NFI Forward 2.0.

While history cannot be an indicator of the future, we believe that the NFI story we experienced in 2015 to 2018 will be a similar one that we see in 2023 to 2025. Some of the factors that drove our outperformance during those years:

- operational and leverage efficiencies;
- multi-year contract benefits; and
- profitable vehicle product mix underpinned by a strong aftermarket business.

In addition, since that time:

- we've increased insourcing through Carfair (for fiberglass) and KMG (for a variety of components) – keeping more margin in-house;
- acquired Alexander Dennis, providing an international growth platform in both manufacturing and aftermarket, that now makes up over 25% of our revenues; and
- Enhanced other services including Infrastructure Solutions, Connected Vehicles and more advanced web-based aftermarket parts sales platforms.

I'll now turn it over to Paul to close.

Paul Soubry ^ Thanks, Pipasu.

I hope that from the discussions you've heard this morning, it's clear to everyone that while the past couple of years have been challenging our future is bright. No one could have predicted the disruption and headwinds that we saw in 2020 to 2022 and while the world remains volatile, we have seen signs of improvement, and the path ahead has become clearer. As we have done since the beginning of the pandemic and through the supply disruption, we remain focused on our people and the bigger picture, and we will deliver for our stakeholders. Today and in the future.

In closing, on Slide 44 I recap our investment thesis.

- We are leaders in our markets, in market share, in vehicle technology, in aftermarket support and in track record.
- Our business is benefitting and will continue to benefit from historic investments in public transit.
- We have deep customer relationships, significant expertise in designing and manufacturing complex, customized vehicles with integrated technology from a multitude of suppliers.
- We drive our business through operational excellence, a commitment to LEAN and in-sourced components where it makes financial and strategic sense.
- We have the facilities, capabilities, and production lines in place to drive our recovery – with significantly lower overhead and SG&A.
- We are focused on our capital allocation priorities to delever and strengthen our balance sheet.
- We are poised for significant improvement in our financial results as we execute to our plan and deliver on our backlog, record bid activity, and deliver volume leverage. We believe in our targets and the fact that we will see significant ROIC growth moving forward.
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The entire NFI management team is focused on the task at hand. As always, we are proud of history and excited about the future ahead.

We'll now open the line for analyst questions. [Operator], please provide instructions to our callers.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) Our first question comes from the line of Chris Murray with ATB.

Christopher Murray^ Yes. Just maybe talking a little bit about your guidance for a couple of pieces. So I guess the first piece of this, just trying to understand maybe some of the other moving parts, especially in 2023.

You've talked a little bit about the fact that I think if we go back to the credit facility disclosures, maybe [Adjusted] EBITDA in the first half of a loss of about $35 million and then the ramp in the second half.

Can you kind of walk us through what the cadence looks like in this guidance? And as part of that, you've been running about call it, $20 million-ish in [Adjusted] EBITDA a quarter in the aftermarket business. Can you just sort of walk us through how that's going to progress through 2023 as well?

Pipasu Soni^ Okay. Chris, this is Pipasu, so a couple of things. We do expect our NFI Parts to be somewhere in that range, which you just kind of described,roughly a little bit lower than $20 million the first 3 quarters, and then obviously kind of getting into a little bit higher mode as we get into that last quarter, which is pretty typical.

In terms of the businesses, Paul kind of mentioned this. But, at the end of the day, we are dealing with the hangover that we've got with the inflation contracts. So if we think of our mix, especially in our North America business, one of the things that we're dealing with today is the fact that we have half of our contracts that have some inflation adjustment that we're trying to work through as we get through the first of this year.

So that's kind of what's happening right now. And then we expect that recovery in that back half. Does that answer your question? Or did I maybe miss 1 or 2 points?

Christopher Murray^ Yes. I was just trying to understand if there's -- I mean -- so it's fair to think maybe just to paraphrase, relatively flat, maybe a bit of a step in Q4 for aftermarket, and then kind of triangulating losses of up to $35 million in the first half and kind of backfill as we go.

Should we expect there's going to be any sort of Q4 step-up or any -- historically, I think back to the days of when you guys had the coach business, it was very Q4 heavy. Or should this be more of an orderly ramp into 2024?

Pipasu Soni^ Yes. I mean, at the end of the day, we do expect a little bit of a step-up. Obviously, our Alexander Dennis business has a step-up in Q4 as well as we do have some of that happening in the coach business as well. So, the way we're kind of thinking about it is, obviously, the first half will be somewhat flattish. We get that lift to get to our guidance range kind of in that Q3 and Q4 time frame with Q4 being our strongest quarter.

Christopher Murray^ Okay. And then my second question, just going back to the 2025 target. So you kind of kept the revenue target in there. But you've gone to the low end of the range of your [Adjusted] EBITDA target.

Again, sort of thinking about longer-term margin profile, I appreciate there's been some stuff that's happened in 2020 and 2021 with inflation in parts costs. Given that we're relatively far enough away from there; can you talk about the pricing environment or your ability to pass those costs on as we get into later years? Because I would assume that, at this particular point, you don't have a lot of 2025 billed yet. But maybe help me understand what you guys can do or what leverage you can pull to work on margins just through pricing?

Paul Soubry^ That's a good question, Chris. In 2023, as you articulated and as we tried to explain in the call, we still have work working through the system, primarily in the first half of this year that was bid a year or two a year ago where we have hyperinflation and FX dynamics that have come through the system and will depress margins in the first part of this year.

That starts to show back to some level of normality in the second half of the year. As we get through 2024 and 2025, the work that we expect in that window is stuff that we're actually bidding on now will bid on in the next year. We have taken a fairly aggressive position with not only trying to get firmer, tougher, clearer quotes from our supply community. We have embedded our costing with any of the elevated inflation that we've already had plus anything that we expect to have.

We have tried to add a level of conservatism, where it makes sense. And we have gotten way more focused on trying to work with our customers about how PPI and any of those indices will make their way through into our prices going forward.

So we're in an environment where we're A: recovery; B: trying to bid based on reality of what prices and costs are going to come into our COGS. We're in a stronger bid environment right now. Because of the demand profile, we have less, what we'll call competitive irrational pricing.

And so we're seeing a lot more reasonableness in the quotes that we're providing and our competitors are provided. The customers, there is no question are aware that prices have gone up dramatically as a result of input costs. So that's kind of how we've reflected it, both in what we think our margins will be, but also how we've tried to price going forward.

Lots of components in that, but we're actually quite comfortable. And what we're seeing in terms of our proposed bid margins on the awards we're getting today based on stuff we've bid in the last 6 months, we're really encouraged about the next chapter, 2024 and 2025, which reflects in our guidance.

Christopher Murray^ Okay. I mean I guess maybe a different way to ask the question. As I look at your 2019 pro forma results on -- arguably for 2024, which is going to be higher revenue, you actually have a lower [Adjusted] EBITDA margin, but aftermarket should be fairly flat.

So I'm just trying to understand, is there something in 2024 that's going to structurally keep those margins in place? I mean you've given us a bridge on where you get to for 2025. But is there still kind of drags into 2024 that will be going through the manufacturing business?

Paul Soubry^ We don't see that, quite frankly. What we're seeing in terms of how we're pricing today and the margins, we see that happening. A couple of things are going to continue to happen in 2024 and 2025 that will be differential to what we saw in, say, 2018 or 2019.

Number one, we have a higher percentage of zero emission. And as we've described, the margins on zero emission, whether it be battery-electric for any customers out on trolley electric or fuel cell-electric, the margins are noticeably higher. The second issue is that we are still continuing the ramp-up of our business through 2024.

So the unit growth will continue through the second half of this year and through 2024 and into 2025 to get back up to close to, not exactly the close to pre-pandemic levels.

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

Cameron Doerksen^ So I guess a question on capital needs. You filed the base shelf prospectus earlier this week. I'm wondering if you can maybe just go into a little more details on why now. I guess maybe I'm wondering, is this related to early discussions you're having with the lenders on the credit agreement? Is this something that they've requested that you do? I'm just wondering what sort of the context around why you filed this now.

Stephen King^ Yes. Thanks, Cameron. So as you know, we are going through the continued discussions with our banking partners on putting a new multi-year long-term credit agreement in place.

As we mentioned on the call, from a capital perspective and capital inflows obviously focused on unwinding inventory and looking at additional things if it's sales leaseback and advanced payments and additional customer deposits.

As Pipasu mentioned, we are considering, and we always consider, capital markets activities. We haven't had a shelf in place before. But we thought it would be smart to put one in place just to have it in case that we do need to pursue anything down that path and would help with timing.

I wouldn't say it's driven primarily by the credit. But I would say as we look at the next couple of years and we look at our multi-year credit agreement, we're focused on putting that in place first. That's definitely our priority. And that shelf can assist if we did have to go down that path, for any kind of capital market action.

Cameron Doerksen^ Okay. I guess just on that front, I mean, I just wonder if you can just talk a little bit more about the working capital trends. You've mentioned you expect to generate, I guess, for the full year cash from working capital.

Maybe you can just talk about your expectations as sort of by quarter, I assume you'll probably generate cash from working capital in the next couple of quarters. But what are the cash needs as you ramp back up production in the second half of the year?

Stephen King^ So yes, I think as Pipasu mentioned kind of our cash needs, yes. As you look at the forecast, we had a pretty significant unwind of inventory, $127 million in Q4, which helped us to outperform our liquidity expectations to end the year.

As we look at the first half of 2023, we expect some still continued inflows from unwind of inventory, but a little bit offset, a little bit muted by some of the deferred payments that we received in 2022, the deferred payments and advances from customers.

As we look at the first half of 2023, we also expect, as Chris mentioned, to being more of a negative [Adjusted] EBITDA position. So, then that would have a cash burn when you look at [Adjusted] EBITDA, then negative [Adjusted] EBITDA, interest, CapEx, leases somewhat offset, like I said, by unwind of inventory.

As we get into the second half of the year, we start to ramp up production. Now Q3 and Q4, generally speaking, we typically are investors in working cap in Q3 and then an unwind in Q4 as we deliver a lot of the inventory and deliver a lot of the vehicles.

But, all that to say, if you look at the kind of the view is that, yes, first half is probably more a working cap inflow and second half, maybe a bit of an outflow on working cap from a cash perspective.

And then when you look at expectations for Adjusted EBITDA in the $30 million to $60 million range, and you've got interest, CapEx, leases on top of that. That's the way to think about, I think, the cash burn in 2023.

Pipasu Soni^ Yes. I think maybe just to add to this real quick, a couple of things. Paul had kind of mentioned this; Stephen has kind of mentioned this, as well. But we are being a little bit more aggressive on prepayments, as well.

As we think about it, we do expect that second half of the year, especially, we will have a little bit more working capital. But at the same time, we do have a significant amount of WIP that will kind of lessen that burden to a certain degree.

So today, when I think about working capital, we are expecting somewhat of an unwind as we get through the year, but maybe not to the level that we had this year.

Cameron Doerksen^ Okay. That's helpful. And just final quick one for me, just on, I guess, the minimum [Adjusted] EBITDA covenant that you have right now. I guess it first gets tested on March 31. Maybe you can get with 2 months done in the quarter; what level of confidence do you have that you'll be under that covenant?

Paul Soubry^ I'm extremely confident at this stage. I feel good about where we're at as a business, especially on that type of covenant and to be able to perform in the first quarter, we feel good.

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

Kevin Chiang^ I was wondering, when you look at your backlog, we saw the option conversion fall pretty dramatically in 2020. I suspect some of that was supply chain issues. The other being maybe some of the backlog or options associated with ICE vehicles, may be less desirable as everyone transitions to ZEBs.

I'm just wondering, when you look at the potential demand out there through your backlog, what type of conversion rate do you think you'll be expecting as things normalize between your ZEB, which I suspect would be pretty high versus ICE? Do you think they rebound? Or do you think they kind of continue to hover at levels you've seen in the past couple of years here as transit agencies make this fleet conversion?

Paul Soubry^ Thanks, Kevin. First of all, not one of the reductions of the option conversion had anything to do with supply chain or us not able to deliver a bus, absolutely no correlation and no impact. It is 100% around the continued evolution of the fleet replacement plans at transit agencies.

If you take a customer that put an order with us with a 5-year contract back in 2018 or 2019 or 2020, that was a 5-year view that had a certain level of either natural gas buses or diesel buses. They've now gone to their Board. And the Board has now got pressure on more zero-emission deployment.

They've now got a completely different avenue for federal funding. The desire to accelerate or participate earlier at zero-emission is the only driver associated with the burn-down with some of those diesel or natural gas options.

Absolutely, we expect that conversion rate to recover as our backlog of now zero-emission or even hybrid-electric buses continues to grow. A number of operators who wanted or expected a diesel natural gas that aren't ready for full zero-emission are moving to electric hybrid.

We absolutely expect that to get back up into the north of 50% ratio. And if you look at the total number of backlog that we've added, even with the burn down of options, we've actually increased our overall backlog. It's quite dramatic. We're not worried about that demand side. And it is absolutely nothing to do with our performance or the supply chain dynamics.

Kevin Chiang^ Okay. So it seems like you're pretty comfortable that even on the ICE side, you'll see some decent option conversions as we kind of get through the next few years here. As you pointed out, not all transit agencies are prepared to go 100% in the near term?

Paul Soubry^ Well, I'll just point to Toronto, for example. Significant contracts last year awarded to us on hybrid electric, which is really seen as a step or a bridge ultimately to zero emission.

But in addition to the buses, and as we've talked many times, the charging infrastructure and the energy draws, there's a multiyear strategy and capital investment platform that's required to do that. So, there is no question that we're seeing a drawdown on the diesel or the natural gas type options.

We're still seeing some be put in place. But the quality of our backlog going forward and the high percentage of it that is zero emission has given us a lot of confidence that the conversion rate will rebound into the neighborhood we've seen in the past years.

Kevin Chiang^ That's helpful. And then just as I think of the cadence over the next, I guess, 3 years here inclusive of 2023. If I look at 2024, and I know you don't want to get too specific in terms of what, how [Adjusted] EBITDA trends each quarter in 2023.

But let's say, in Q4, you're somewhere in the area of $40 million of [Adjusted] EBITDA just to throw a number out there for Q4. That does suggest maybe 2024 could see almost a doubling of earnings on a run rate basis, first of what you're exiting 2023 at? What does that mean for working capital?

And when you look at that that additional ramp-up in 2024, just how much of the supply chain, and how much more does the supply chain need to improve to get there? Are you comfortable that the current operating environment allows you to inflect pretty significantly here as you enter into, I guess, next year?

Paul Soubry^ Well, let's talk about the supply chain in isolation. We tried to comment on that in some of our comments today. The number of suppliers that are in what we call red, or high-risk and high-impact, categories dropped dramatically over the last couple of months.

We were in a world of hurt, quite frankly, for most of 2022. That's not to say we're out of the woods. We still have some issues with certain suppliers. And we still have certain suppliers in the United States, for example, that are not delivering electronic components that have people dynamics that impact their ability to deliver.

But the position we're in today and what we forecast to project going forward, in addition to supply chain health, what we're doing to enhance that, for example, longer windows in terms of the engineering timeline or giving ourselves a broader time to be able to do supply chain and working with longer supply lead times, all those things are giving us more and more confidence.

Yes, there's still a couple that are of a concern. But we're in a materially different place. The discussion we've had today about changing dynamics associated with customers. I go back in time when we had diesel buses. And we've introduced hybrid electric buses; it was a materially higher withdraw on the businesses.

And at that time, the FTA allowed for milestone payments or early payments to fund the working capital. We're now having very encouraging conversations with the FTA to be able to fund the higher working capital associated with the zero-emission or specifically the battery components on buses.

The other dynamic is our aggressiveness in working with customers on how we bid or how we negotiate payment terms to effectively try and change that dynamic as well. I am cautiously and comfortably optimistic that the working capital draw will be commensurate with the growth of the business, not impacted by the supplier performance.

Kevin Chiang^ No, that's helpful. And maybe just lastly for me. As you kind of ramp through here, do you have a large inventory of battery packs ready to go. It feels like that seems to be -- just broadly speaking, the commercial vehicle OEM sector, some kind of ongoing, I guess, broadly ongoing concerns around the ability to source more batteries over time, just given the large transition of all vehicles to electric.

Is that something you're looking to hold more inventory of than maybe some of your other critical supplies here? And do you have an update in terms of how much you're holding today and how much visibility that gives you as you ramp up through 2023?

Paul Soubry^ Well, so there's a couple of dynamics. Rewind a couple of years ago, we only had one source of battery supply. We're now actively testing and ready to deploy by the end of this year, a second source of battery supply, different types of batteries. Cylindrical cells with a different provider, ABS. In the case of ABS, they've already pre-purchased a certain quantity of batteries for the next couple of years to run through their supply chain to ultimately provide the battery modules to us.

We've also then decided in the UK case that Alexander Dennis' source of battery supply is going to be different and diversified from what we do in North America to allow us multiple sources to be able to manage our way through that. Also, keep in mind that our quantity of batteries is for, let's call it, a couple of thousand buses a year as opposed to a couple of thousand cars a day or trucks a day and those kinds of things.

So, yes, it is a concern for the longer term given the whole conversion of the entire world fleet of whatever vehicles to zero emission. We are really trying to make sure that we've got multiple sources and trying to continue to be cell-agnostic to allow us to pivot faster rather than committing to only one technology or one source as this game starts to unfold.

It is no question a reality and a risk. We feel pretty comfortable with the position that we're in and the strategic choices we've made.

Kevin Chiang^ That's it for me. Best of luck as you get through 2023 here and, obviously, a very strong demand environment.

Operator^ Our next question comes from the line of Daryl Young with TD Securities.

Daryl Young^ Most of my questions have been answered, but just one last follow-up. Ridership trends have been improving in some of the larger gateway cities. But I'm just curious what kind of pain you're seeing on the transit authorities in those major gateway cities from the fare box?

And what that means for their ability to fund their 20% CapEx of future EVs just given the cost profile going so much higher? I know there's obviously tons of federal funding out there. But just what that means at the transit authority level in their operating budgets.

Paul Soubry^ Yes. I think the funding environment, what we've seen, just given the massive size of the IIJA and then the U.K. funding environments, definitely helped, I think, support a lot of transit agencies confidence in their abilities to execute on their fleet renewal plans or project plans or capital plans.

No doubt there are some transit agencies who definitely felt a lot of the ridership impact throughout the pandemic and then into the recovery. We have seen from APTA, I think, we're back to kind of 70% plus in North American transit across the board for those that have reported.

In the UK, I think kind of a similar level. It's kind of 70% pre-pandemic. We've definitely seen a lot of movement of people going back to the office if it's a hybrid or move away from work from home. I think ridership stats are starting to increase.

There's always a concern in a recessionary environment of, yes, will they have that extra 20%. Now the good news, I think, is with some of the new funding that we've seen either through the IIJA or some of the proposed funding in the United Kingdom is that they may be able to get 100% for some of their vehicles.

They may not even have to have that 20% commitment. I would say we haven't seen anything or heard anything from our agencies that gives us any concern about their ability to fund their capital plans. As we've seen bid activity, record levels, 10,500 active bids at the end of the fourth quarter and the 5-year outlook continues to remain strong.

Our discussions with transit agencies, they still see the view that they're going to execute their capital plans and that the funding is sufficiently there to support that view.

Pipasu Soni^ I'll also add, Daryl, that we continue to try and keep in mind that these are government public transit agencies, specifically in North America. And, while ridership crushed them through the pandemic and has been slowly recovering, public transit agency is working to a 5-year or a 10-year fleet replacement plan.

And every single city mayor, every governor. We had a visit from the Vice President or the FTA Administrator. In addition to the environmental impact of the type of propulsion, they're all massively interested in reducing congestion and improving flows in cities.

While they're dealing with today's realities of lower ridership, they're also trying to find a way to get more and more people through public transportation through those cities over the next 5 or 10 years. So, their time horizon, notwithstanding short-term funding dynamics and so forth, is a lot longer than normal private business that will adjust capacity or adjust plans in the short term, dealing with more short-term dynamics.

So we sit there and talk to an agency about their propulsion dynamic, but also the city congestion dynamic, and then the whole telematics and preventative maintenance and parts and all stuff to try and improve reliability and reduce overall operational costs that are effectively mitigating some of what they may have lost in the fare box.

I would argue that there is more and more pressure and more and more desire to get people on public transit rather than the shrink public transit agencies. Notwithstanding every city is going to deal with their local funding and the ridership dynamics uniquely.

I think that is what Stephen said reflects the strong federal investment, but also the strong bid universe that we've continued to see.

Stephen King^ We have one question from our chat from an investor. The question goes, “Precisely what factors led you to believe that supply chain issues can enable a ramp-up of production in the second half of 2023 and your confidence level in this ramp-up?”

Paul Soubry^ Well, so we know every single supplier, and we've rated every single supplier. We have an order book. We have a schedule that's effectively sold out for the entire year, almost every single slot.

Our supply chain knows that. They know which customers, which builds, they know what month, what line entry rate, and so forth. We are really proactively trying to effectively do a couple of things: a: ensure that we have the production schedule in place and on time.

We're continuing to work with those customers in trying to mitigate any of the additional price changes that we've seen in the past. We continue to try and allow longer production times or longer preproduction times today to allow their source of supply to provide on time.

We have worked where we can on alternate sources of supply, not only at the prime level to us or Tier 1, but Tier 2 and Tier 3 and 4 suppliers. We have, where we can and where it's appropriate, moved from roughly 5, 6, 7 days of point-of-use inventory online to, in some cases, we're migrating to 15 or 20 days of inventory online.

All those things contribute to the fact that we feel much more confident in the back half of this year to start to grow our production rates. The other side of that equation is people. And we continue to have excess people for today's production rates inside our business as we burn down a deal with WIP production, which will give us additional capacity in the second half.

And, quite frankly, it's not like we need to hire thousands and thousands of people to meet our second half production schedules. We probably, across the business, have somewhere in the neighborhood of 150 to 200 people to hire to be able to deliver to that. So, not an insurmountable task to be able to run to that increased rate in the second half. We're very confident on margin profile of that business as we move through the rest of 2023 and into 2024. Thanks for that question.

Stephen King^ Okay. I think, Michelle; that was it for questions on web.

Operator^ And I'm showing no further questions on the phone lines.

Stephen King^ Okay, great. Well, thank you, everyone, for joining us this morning. Please, as always, continue to visit our website where all of these materials can be found and please do contact us at any time. Should you have any questions, our investor contact details are all available on our website. Thank you so much for joining, and have a great day.

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