NFI Group, Inc(2024 Q2 Results)
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Corporate Speakers

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

Participants

- Chris Murray; ATB Capital Markets; Analyst
- Cameron Doerksen; National Bank Financial; Analyst
- Tamy Chen; BMO Capital Markets; Analyst
- Daryl Young; Stifel; Analyst
- Unidentified Participant; CIBC; Analyst

PRESENTATION

Operator^ Good day. Thank you for standing by. Welcome to the NFI 2024 Q2 Financial Results Conference Call.

(Operator Instructions) Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your first speaker today Stephen King, Vice President, Strategy, Investor Relations.

Please go ahead.

Stephen King^ Thank you, [Shawn]. Good morning, everyone.

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

On today's call Paul and Brian will provide an update on our second quarter results including significant year-over-year improvement across our financial metrics and provide an update on the operating environment, market demand and our outlook.

This call is being recorded. And a replay will be made available shortly.

We will be using a presentation that can be found in the Investors section of our website.

While we will be moving the slides via the webcast link, we will also call out the slide 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 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 measure statements found in our press releases and other public filings on SEDAR for more details.

A reminder that NFI statements are presented in U.S. dollars. The company's reporting currency and all amounts referred to are in U.S. dollars unless otherwise noted.

On slide 3, we have included some key terms and definitions referred to in this presentation.

Of note, Zero Emission Buses or [ZEN], refers to vehicles that did not have -- do not have internal combustion engine.

This includes 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, 5and 6 provide a brief overview of our company. More detailed information is available on the NFI Group website.

NFI Group is a global independent bus and motor [coach] solution provider that is leading the evolution to zero-emission mobility.

We are purpose-driven and exist to build vehicles that move the world's most precious (inaudible). We exist to move people.

We also play a critical role in the global journey to reduce emissions through every ZEB that we design, build and put into service.

Slide 7 provides NFI's latest zero-emission statistics.

Since 2015, we've delivered over 4,000 EUs of ZEBs that have completed over 195 million electric service miles in more than 150 cities in six countries.

Our Infrastructure Solutions team has also installed over 495 electric bus chargers totaling more than 80 megawatts of capacity since 2018. Demand for ZEBs continues to accelerate with a record 41% of our current backlog being ZEBs. And based on our analysis, more than 50% of anticipated North American transit customer purchases over the next five years will be electric buses.

We continue to project that at least 40% of our 2025 deliveries will be ZEB.

I will now pass it over to Paul to provide an overview of our results for the second quarter.

Paul Soubry^ Thank you, Stephen. Good morning, everyone.

Thank you for joining us today.

I'm now on slide 9. This slide provides a summary of the second quarter of 2024 for NFI.

Our financial results showed positive year-over-year improvement with double-digit growth in vehicle deliveries and revenue, significant improvement in manufacturing margin performance our first quarter of net -- positive net earnings since 2021 and nearly 400% increase in adjusted EBITDA.

Manufacturing margins saw a significant improvement, reflecting pricing and production rates. Margins were impacted by legacy inflection -- margins were impacted by legacy inflation impacted deliveries, though we have now materially completed all of those remaining contracts, which will help drive further margin growth as we move through 2024.

On the demand front, we had new orders of 1,114 EUs in the first quarter, a 21% increase from the previous year.

As expected, the new [awards] were down from the first quarter where we recorded our highest awards ever of 5,421 EUs.

Our trailing 12-month book-to-bill ratio remained strong at 107%, even as we increased deliveries by 31% over that period.

Our option backlog conversion rate also showed continued recovery, now reaching 52% for the second quarter of 2024.

NFI's aftermarket segment delivered yet another quarter of record performance. with $162 million in revenue and $35 million of adjusted EBITDA, both up 18% year-over-year. These results were primarily driven by increased volume in North America, pricing improvements and continued product mix development.

Our quarter ending backlog saw a slight decrease in units, but an increase to $11.8 billion in total value, another record for NFI. The average selling price for vehicles in our backlog also continue

to grow by 19% year-over-year, reflecting a higher portion of zero-emission vehicles and the pricing actions we've taken in contracts from [mid-2022] onwards.

Our focus to manage working capital was another bright spot with improvements in working capital days both year-over-year and sequentially. This, combined with positive free cash flow generation helped us maintain a strong quarter ending liquidity position even as we increased our production rates.

On the supply front, we continue to work very closely with our suppliers to monitor performance with our dedicated supplier development program.

While we've continued to see a reduction in the number of moderate and high-risk suppliers, there have been delays for certain components including seats and wiring harnesses for [electro] buses being the primary areas of focus. These are not global supply type challenges like we have with microprocessors, but rather isolated short-term delays, we're actively managing with specific suppliers.

We expect these types of delays will continue through 2024 as our suppliers ramp up their operations alongside our production increases and as we increase the percentage of zero-emission production at NFI.

Our strong backlog has helped us mitigate some of these risks by providing longer-term visibility to our suppliers.

In addition, we have continued to strengthen our ZEB supply base, bringing on additional suppliers from specific regions and partnering with larger, more established ZEB component suppliers such as Accelero, BAE, Impact and Ballard.

We achieved our hiring plan in the quarter, even with the continued tough labor market, primarily still in the United States.

We expect we'll continue to add new team members in '24 and '25 and but at much lower rates than we did in '23 and the first half of this year as we now focus on driving production rates higher through improved labor efficiency. The training demands to bring new people up to speed on our production lines with zero emission vehicles cannot be underestimated.

Slide 10 shows the quarterly inventory balance as compared to line entry rates. The line entry rate saw a 28% year-over-year increase and a 2% increase for the first quarter of 2024. This reflects our ongoing production ramp-up. The increase was driven by healthy backlog, strong continued customer demand and improving production efficiencies. The ramp-up is a phased approach, matching consistent supplier performance with labor, trained labor availability and ensuring a trained workforce continues and our customers' abilities to inspect and accept this next generation of vehicle.

We are being measured as we ramp up to ensure we do not build up excessive offline buses as they require a significant rectification and outsized investments in work in process inventory and increasing interest expenses.

Inventory balances were up 6% from the quarter with work in process and raw material balances increasing offset by lower finished goods. The increase in raw materials reflects the higher number of ZEBs planned for the second half of the year and we've continued to carry certain safety stock of parts, reflecting very focused supply chain performance.

As our supply chain health improves and as we continue to reduce high-risk suppliers, we anticipate that we'll be able to lower these additional redundant safety stock levels over time. The second quarter was a positive step in our recovery and growth. Based on first half results, we are well positioned to deliver on our targets.

And I'll provide more detail after when I discuss our outlook a little later in the presentation, but for now Brian will provide a deeper dive into our quarterly results.

Over to you, Brian.

Brian Dewsnup^ Thanks, Paul. Picking up on slide 11.

Our multiyear backlog remains strong with another quarterly increase in option orders, which now extend all the way to 2029.

Firm orders were down slightly, reflecting higher deliveries in the quarter. across all our product lines, we saw year-over-year growth in deliveries with low floor cutaway deliveries up by an impressive 73%.

Turning to slide 12.

Overall gross margin improved year-over-year from 7.3% to 11.9%.

We're, especially, pleased to see the progression in manufacturing, which achieved an 8% gross margin, the highest since the first quarter of 2021 and a significant jump from the 0.9% margin in the second quarter of last year.

We project that manufacturing margins will see continued improvement as we move through 2024, driven by improved production efficiencies, stronger pricing and contracts that were bid in 2023 and the fact that we now have materially delivered all legacy inflation impacted contracts. Aftermarket gross margin percentage was up year-over-year to 28.5% but down slightly sequentially.

This decrease reflects higher public sector sales on large customer mid-life overhaul projects.

On slide 13, we provide segmented adjusted EBITDA. The Manufacturing segment was up 313% year-over-year and was nearly equal to the aftermarket segment. This growth was driven

by higher deliveries and gross margin improvement. The Aftermarket segment saw an 18.2% year-over-year improvement and had a very strong first half of 2024, outperforming expectations.

Turning to slide 14.

We reported our first quarter of positive net earnings since the second quarter of 2021 with net earnings of $2.5 million, a year-over-year increase of 105% or $50 million. Positive earnings in both Manufacturing and Aftermarket segments were offset by corporate expenses. Adjusted per share was a positive $0.02 and $0.03 on an adjusted basis.

We also provided a chart on this page that reconciles net loss to adjusted net loss including normalization items.

I'd like to remind you that in our MD&A and press release, we've included reconciliations for all non-IFRS measures.

On slide 15, free cash flow was positive for the quarter and saw a 104% improvement from the same period in 2023.

Free cash flow was primarily driven by increased cash generated from operating activities and lower cash interest expense linked to the timing of payments on our second lien debentures.

We did see a $22 million investment in working capital during the quarter, reflecting the investments in inventory balances that Paul discussed, offset by increases in deferred revenue.

On slide 16, NFI's total liquidity was up $13 million from the first quarter, ending at $179 million despite higher volumes. Total liquidity was positively impacted by the same items as free cash flow, offset somewhat by our investments in working capital.

Our overall cash generation allowed us to make a small repayment in our North American and U.K. secured facilities in the quarter.

On this chart, we also outlined NFI's debt maturities.

While we're focused on deleveraging our balance sheet by increasing adjusted EBITDA and delivering free cash flow to support debt repayment, we've also begun investigating options to reposition certain debt balances to other debt instruments. This may provide an opportunity to lower our overall interest expense. This is an initiative that we will be actively pursuing during the remainder of 2024 and hope to provide additional information on as we advance these efforts.

Finally, subsequent to the quarter end, we amended our performance agreement with Export Development Canada, increasing capacity under our letter of credit support facility by $25 million which is expected to support our liquidity and bonding going forward. This program includes a performance security guarantee of up to $90 million, which was previously up to $50 million. This is in place to cover standby letters of credit or letters of guarantees required as part

of collateral packages provided to support surety bonds, which are typically required by transit agencies in North America to support bus contracts. These collateral requirements have increased over the past couple of years, and we now have $94 million in outstanding letters of credit.

I'll now turn the call back to Paul.

Paul Soubry^ Thanks, Brian.

On slide 18, we provide a summary of some of the key public demand metrics for North America. Total active bids of 6,792 EUs including 3,153 EUs and bids already submitted and another three of EUs that our bids are now in process is an increase from the first quarter of 2024. Year-over-year, we saw a slight decline in total active bids, driven primarily by the conversion of very large awards from New York and New Jersey and from other customers to NFI that led to record orders for the first half of 2024.

Our five-year expected public bid forecast is now 21,450 EUs, which is developed using customer fleet replacement plans and projections, combined with active bids in process and supports our view that public bus and coach demand will continue to remain very strong, reflecting a strong funding environment.

On slide 19, we provide a summary of key market updates.

In the United States, the FDA announced focus -- announced funding for the 2024 Low or No emission grants commonly referred to as the Low-No program. There were $1.1 billion in grants available for buses and associated infrastructure in 2024, and NFI expects to have another strong performance this year, surpassing our previous record in 2023 and we were named by a specific customer on over $200 million of grants. The announcements have been made by the FDA, and we're actively tabulating the results and plan to provide additional details to you in the short term.

We've included a chart here from the American Public Transit Association that shows specific grant funding for bus and bus facilities and the Low-No program.

As you can see on the chart, there has been a dramatic increase in dedicated funding through the Infrastructure Investment and Jobs Act to support the continued rollout of Low or No emission buses across the United States.

In Canada, the government recently announced details on its 30 million -- sorry -- 30 billion public transit fund the largest public transit investment in Canadian history. A fund, which includes dedicated funding for large public transit systems will be distributed over 10 years, starting in 2026. This funding is in addition to the over CAD17 billion in federal funding to support Canadians that is already in place until 2027.

In response to the growing Canadian demand for NFI products, it is now actively -- NFI is now actively working on enhancements to our heavy-duty transit manufacturing footprint in

Winnipeg, that would enable New Flyer to build complete transit buses for Canadian customers in when it takes starting in late 2025.

In the United Kingdom, the zero-emission bus regional areas or ZEBRA program, continue to drive electric and fuel cell bus procurements. Alexander Dennis has continued to secure new contracts with customers under the ZEBRA2 program in England.

Finally, I'll provide an update on our continued efforts to strengthen the bus manufacturing industry within the United States.

As we've previously discussed, the FDA issued a dear colleague letter to transit agencies in February of this year that provided clarity on the ability to utilize progress payment structures within bus contracts complete price adjustments on legacy firm contracts and include price indexing on new firm contracts.

It also calls for active efforts to reduce customization on new bus orders.

We have begun incorporating milestone payment or billing payment structures into new contracts wherever possible at standard terms. This would provide payments through the build period of a new vehicle rather than current process of receiving 100% of the purchase price following delivery, customer acceptance, plus 30 or more days for final payment period.

These structures have only started to be introduced into new bids and contracts following the FDA Dear Colleague letter.

We've also actively pursued progress payments on structures on contracts already in place with reasonable success.

It will take time for the impact of these new measures to fully reflect it in NFI's working capital balances and we will continue to provide insight as things advance.

We anticipate that this will increase our deferred revenue balances as we move through '24 and into 2025.

Turning to slide 20.

Based on our first half performance, we are confident reaffirming our 2024 financial guidance and our 2025 targets.

For fiscal 2024, we anticipate double-digit revenue growth, triple-digit adjusted EBITDA growth and improved free cash flow.

We anticipate zero-emission buses to be 30% to 35% of our total deliveries in 2024, growing to over 40% in 2025.

This does not imply that we will see a significant increase in ZEB deliveries during the third or fourth quarter 2024.

This is in line with our firm -- sorry -- this does imply that we will see a significant increase in ZEBs during the third and fourth quarters of this year and this is in line with our firm backlog and expected production schedule.

We will see an increase in cash CapEx as we catch up on some of the deferred maintenance and as we invest in our continued new product development and growth projects.

For our 2025 targets, we expect to achieve an adjusted EBITDA of greater than $350 million, and we 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 volume of -- a combination, sorry, of volume recovery, production efficiencies, improved pricing a shift away from legacy impacted contracts and an increased number of higher-margin zero-emission bus deliveries.

We have maintained our return on invested capital target of greater than 12% for 2025 and with the potential for outperformance in this metric as we see improvements in our working capital investments and achieve customer milestone payment support.

On slide 21, with the first half of this year, delivering 33% to 38% of our expected full year adjusted EBITDA.

We continue to expect a strong third and fourth quarter weighted heavier towards our typically busiest fourth quarter.

We also show the continued projected improvement in gross margins as we move past those legacy inflected impacted contracts, increased volumes and deliver more zero-emission buses.

Turning to slide 22.

We highlight the increasing average sales price or ASP per equivalent unit in our total backlog, which helps support our ability to reaffirm our guidance. This amount has increased for both heavy-duty transit buses, the dark blue line and motor coaches, the light blue line. Year-over-year, the average selling price for heavy-duty buses in our backlog was up 17% and up 56% since 2021. The ASP for coaches were up 11% or 19% over the same time period.

These average selling price increases were driven by a combination of higher ZEB orders, inflation-adjusted pricing and improved margins in our new contracts.

Now on slide 20, 22, provide a few closing comments, and then we'll open up our call to analyst Q&A.

We were very pleased with our first half of 2020 performance and in line with our projections, especially the continued recovery in the manufacturing segment and the solid performance with our aftermarket.

We saw year-over-year growth at all of our major financial metrics, with positive net earnings and free cash flow while maintaining a healthy liquidity position.

I'm grateful [and] proud of our team now back to nearly 9,000 employees for remaining loyal to the company and working so incredibly hard to deliver these results.

While our recovery is well underway we do not underestimate the work ahead of us managing the risk with a challenging operating environment.

We continue to work together to achieve our plans to deliver for our customers who have been incredibly patient and flexible to accommodate both NFI specific challenges in our overall industry dynamics.

I look forward to continuing improved and positive progress in the second half of 2024, and we anticipate continued year-over-year recovery as we move in 2025.

[Shawn], please open the line for analyst questions and provide instructions to our callers to ask questions.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions)

Please stand by while we compile the Q&A roster.

Our first question comes from the line of Chris Murray with ATB Capital Markets.

Chris Murray^ Yes. Thanks, I guess the first question, and maybe I know you asked this in the last quarter, but -- just looking at aftermarket, again kind of our record performance, very, very strong, both top line and EBITDA margin. Again just can you talk a little bit about the sustainability of this going forward?

And should we kind of expect this is the kind of run rate performance we should expect through kind of the balance of '24 and end of '25.

Paul Soubry^ I think that's a fair assumption, Chris.

As we moved through '23 and put our plans in place for 2024, we were trying to predict kind of the customers' reactions, both public and private to that period of time where we and then, therefore, couldn't supply parts directly to them given supply chain challenges.

We saw we projected that we may see a little bit of a flattening or slowdown of that growth, and that hasn't been the case.

Our customers continue to work on ensuring their pull out and the performance of the vehicles and the readiness of those vehicles.

We continue to work on adding products that make sense to our offering and moving that product through the same rationalized infrastructure that Brian and his team did for so many years.

We have a couple of struggling competitors, some that have gone away.

One of our competitors left the U.S. market from new product.

One of them effectively shut their business.

So we now have some of those customers looking to us to try and fill a gap if we can provide parts for their vehicles.

So we project that business to continue to be strong through '24 and '25.

We'll continue to work on our cost base. The biggest area of opportunity is freight, and we continue to try and manage that.

But I think you're going to continue to see a very strong top line and a reasonable margin throughout 24 and 25 in the aftermarket.

Chris Murray^ Okay. That's helpful.

One of the other questions I get a lot is thinking about as earnings are improving, is the capital structure for the company.

I know in the release you talked about wanting to get back to a leverage ratio kind of normalize somewhere between two and 2.5x.

Can you walk us through your thoughts around the -- call it, the unwind or the refinancing of the company?

And while you're at it, I mean one of the questions we also get a lot of the time is, is there any expectation that you're going to have to issue additional equity to kind of get you back down into that two to 2.5 range?

Brian Dewsnup^ Yes. Thanks, Chris. I'll take that one.

So things have materially changed in the last 12 months in terms of the turnaround of the company.

So we would expect that we'll have more options in the second half of the year and the first half of 2025 in terms of refinancing our balances.

We think we'll be able to get a little bit lower rate.

We do not expect to issue equity.

We believe that we can fund all of our working capital needs as well as our capital spending through cash flows that we generate.

I think we've -- you've seen the liquidity numbers for the second quarter.

And so I think we're well on our way of being a little bit more working capital efficient along with benefiting from some of these milestone payments that we have alluded to in the FDA Dear Colleague Letter.

So just to be clear, we do not plan on [issuing] equity.

Chris Murray^ Okay. Then any plans on either being able to call or shift the senior secured or the second lien?

Brian Dewsnup^ We're taking a look at a whole bunch of options right now which are available to us now that we're doing a little bit better financially.

So we'll continue to look at that, and we'll give you updates as the second half of the year progresses.

Paul Soubry^ Chris, it's Paul. The senior -- as you know the senior secured doesn't come current nor do the government loans until the first quarter -- end of the first quarter of 2026.

So the effort was to get sorry, becomes due at M '26, and therefore, current at the end of the first quarter of 2025.

So we've got a little bit of runway. The markets are open.

Our business is doing better. Brian and his team are working pretty aggressively now to try and assess a variety of options of what we would do next relative to refi.

But there's nothing imminent you're going to hear about in the next day or two.

We're actively looking at that. We're pleased that we'll be able to increase the volume through the business without sucking up working capital.

That has a lot to do with those milestone payments that Brian talked about.

So we're actively looking at what to do and how to change potentially the shape of some of that debt.

Chris Murray^ Okay. That sounds great.

I guess my last comment or last question, I guess is around production rates.

So I think in the release, you talked a little bit about maybe with the new Canadian program for federal spending that you're maybe reviewing, maybe your capacity inside Canada. There's also some other -- I guess some other opportunities, especially with what have to expect is higher market share.

But I also know that you've always been conscious about not trying to outrun the industry, that can be quite cyclical at times.

So when we think about longer term, is there sort of a target kind of idea of what the production level should be for the company, maybe beyond '24 and '25.

So maybe it's a little more theoretical, but just trying to get an idea of like where the terminal kind of production rate is optimized for you guys?

Paul Soubry^ Well, let me start a little bit at the demand thing.

I think in our remarks and some of the graphs you saw, how healthy both the U.S. federal funding, specifically the Low-No program but also in the Canadian environment now with this longer-term $30 billion very, very material focus on long-term and reinvestment and enhancement of Canadian public transit systems. There is a dynamic as we continue to shift from ICE engines into zero emission.

As you know they're more complex.

There's different types of zero emissions. There's different [rays] dynamics, fuel cells and all the other things.

We still have a supply chain that has some challenges. We don't want to run too fast.

Having said that, we continue to increase the volume quarter-over-quarter that's going through our facilities. A Canadian program that would allow us to build Canadian zero emissions, cradle to grave in Canada is something that we're now actively investigating and thinking through in our facilities.

We've been talking to both the Manitoba government and the government of Canada about ways to try and bring some of that capacity back to Canada.

It's probably 15 years, Chris, since we did an all-Canadian build of a public transit bus in Canada.

So I'm not sure we're in a position yet to kind of give you any numbers.

You'll see it really translate through our forecast and our guidance going forward as we increase those production rates.

We're pleased with the pace that we're running at.

We're challenged by a couple of suppliers today. There's still wiring harness continue to be a challenge, even things that we would think would be a problem like seat supply, the repeatability of seats.

Some of those things continue to govern the pace at which we're ramping up the business.

It's not a demand issue.

It's us trying to make sure that we're prudent about the rate at which we run it through and that we don't suck up working capital and use unnecessary liquidity by having stuff waiting for parts supply.

So we're pleased, look, we're recovering very well the rates at MCI, Alexander Dennis is running well the ARBOC business is actually ahead of its schedule in terms of planning its production rates and delivering them and New Flyer is nicely coming along to the wrap up of volumes.

We're probably back production rates for 2025 of that kind of 1,500 to 1,600 total EU production rate per quarter, which is effectively where we were in 2019.

Operator^ Our next question comes from Cameron Doerksen with National Bank Financial.

Cameron Doerksen^ Maybe just to kind of follow up on Chris' question, just around production rates. And just maybe taking a more short-term view. Just wondering how you can sort of maybe give us a little more detail on, I guess the next couple of quarters kind of how the split in kind of deliveries is going to break out for the remainder of the year.

And also, how should we think about the EBITDA generated by quarter the next couple of quarters?

Paul Soubry^ So again we got to go business by business, which we won't do on this call camera.

It's a good question. You're going to see it sequentially go up over Q3 over what it was in Q2. You're going to see it in Q4 higher than Q3. Q4 also has that dynamic that has really an Alexander Dennis and MCI impact of deliveries go up even higher in the fourth quarter just because of the way those things are paid for in tax depreciation strategies of our customers and so forth.

But you're going to see an improvement in Q3 and a more dramatic improvement in terms of volume and deliveries [income].

Cameron Doerksen^ Okay. I guess , from a margin perspective, I mean obviously there's mix differences on the manufacturing side, but would you expect the kind of sequential improvement, obviously in Q3, but then also a sequential improvement in the percentage margin in Q4?

Paul Soubry^ Yes. I think that's a fair assumption. You also remember that we -- two issues that play.

One is the negative drag that we had on low-margin or legacy contracts is now effectively behind us. There's still a few, but it's not material as we move through Q3 and Q4.

So you'll see better margins.

Then Q4 will have an even higher percentage of zero emissions, which have a higher margin.

So you'll see better volume and better margin in the fourth quarter as well.

Cameron Doerksen^ Okay. That's helpful. And maybe just sort of my second question is just around the Alexander Dennis business. You've introduced a new set of EV buses there.

It seems like you're having some decent order success.

Maybe you can just talk a little bit more about that market, what you're seeing as far as the opportunities there. where the kind of production is with ADL.

So any particular details you could provide would be great.

Paul Soubry^ It's a good question, Cam. Just a little context for maybe some listeners that don't know the history, but when Alex entered dentists first did in 2016, '17 got into zero-emission vehicles, they partnered with BYD, where BYD provided the entire battery electric chassis and Alexander Dennis put the body on it.

As that progress -- as that product kind of matured and as the expectations of the operators in the U.K. for more range and better performance, we effectively made a decision not to go with BYD anymore, but to build our own chassis.

So in the last two years, we have launched an [E 400 -- or in viral 400 EV], which is a two-axle double deck on our own electric chassis.

We also still do them on our own diesel chassis and some very small but some on hybrids. The Enviro 500 is the three-axle double deck, which we are now delivering electric chassis -- electric buses into the Asia Pacific region, and that is going well.

We have launched a new product called the Enviro 100 EV, which is a smaller vehicle.

It's about a 28-foot vehicle today sold almost exclusively in the United Kingdom, which has really hit the market with a lot of interest.

We've got deliveries. We've got orders already. We've got deliveries already.

It's kind of a market maker because it's a smaller than a normal single-deck bus and there's a lot of interest in the U.K. from it.

So we will start to see deliveries -- well it already has, but it will see some in the third and the fourth quarter and ramp up next year.

The last remaining product is their normal single-deck bus, which is called Enviro 200.

It has different widths and different links. That -- the reengineering of that chassis, it will be completed probably by the end of this year with delivery starting in the second half of next year.

So as that market continues to recover, we think we're very well positioned from a product standpoint.

I will make a comment, though, that while U.K. is higher than North America on the pace of adoption of zero emission -- there was also some customers that have ramped up orders for diesel buses.

So it's -- the death of the diesel is a little bit premature in some people's mind.

What the -- opportunity for us is taking that technology and capability that we've developed in the U.K. and now leveraging in global markets.

And that's really the next chapter for Alexander dentists. The aftermarket over there has done well. the business is recovering well both on volume and margin.

Cameron Doerksen^ Okay. No. That's great detail. I appreciate the time.

Operator^ Our next question comes from Tamy Chen with BMO Capital Markets.

Tamy Chen^ Paul, a quick clarification here.

I thought hearing emission buses were a lower margin rate, but higher EBITDA dollars per unit.

Is -- am I still understanding that right?

Or zero-emission buses are now also higher margin rate for you?

Paul Soubry^ Zero-emission buses have a higher EBITDA dollar per unit, but a lower margin percent.

If I confuse you, that's my issue.

Tamy Chen^ Okay. Got it. Thanks for clarifying, that was my original understanding.

Okay. Perfect. Then I wanted to revisit your comments about milestone payments.

I think before, maybe it was last quarter, I got the impression that this part of the Dear Colleague Letter may be the most challenging to implement both of existing programs with existing customers work but also in new contracts that you're bidding on now.

It sounds like there's actually some good progress being made here.

Could you just talk a little bit more about that?

Are you seeing transit agencies now being more willing to incorporate this?

Paul Soubry^ It's a really good question, and thanks for the opportunity to clarify.

So the original meeting was in January in the White House and then immediately, there was the issue of Dear Colleague Letter. And all of the guidelines coming in that letter were the clarity around the contracts allow for milestone payments. The contracts allow for inflation readjustments and so on and so forth.

What we tried to explain to our investors is, going forward, we will now in every bid that we can in every contract that we signed in trying to embed milestone payments.

The reality is the stuff that we're bidding now we don't build 12 to 18 months from now.

So the impact is delayed.

We also told our investors that what we were going to do is to go back to every customer that we had a contract in place or that was coming up that we would start to build and try and negotiate milestone payments into it.

Some customers have not wanted to do that.

A number of customers have done that.

So we've been successful in North America, but I can also tell you in the U.K. where government funding has helped them buy some vehicles that we've been successful at already achieving some of those milestone payments, which is part of the reason why you see volumes going up and yet we're still being able to tread water on liquidity.

Brian, you can give some color on the magnitude that we've seen so far.

Brian Dewsnup^ Yes. I think if you dig into the financials, you can see round figures since the beginning of the year, we've been able to increase milestone payment balances by about $45 million over the first half of the year.

So it has been helpful.

It hasn't changed our working capital by hundreds of millions, but it has been helpful in 2024. And as we've indicated earlier, some of the contracts that we're negotiating and signing today will have a bigger milestone effect, if you will, in 2025, but we are still actively pursuing milestone payments and contract negotiations and the work that we're doing in the second half of 2024.

Tamy Chen^ I see. Okay. Thanks for the magnitude there. And last question I had is on the zero emission buses.

So I remember a few quarters ago, you had to redesign the area that contained the battery for better drainage.

I want an example of one of the things that you're learning as you go in this newer area. And both in the press release and in the commentary you had on the call you called out -- the supply base is still nascent, all of these factors.

So I just wanted to level how should we and investors think about as EU do ramp up more and more of your emission buses is still a new area.

I think it's just been difficult to understand what are still some of the risk areas, what parts of the list you provided where are you the most with respect to the execution just because this is still a newer part and -- but it's going to quickly become more and more meaningful for your deliveries?

And maybe you could also update us on the cash cycle for zero emission buses because I think I recall you said they're longer than the diesel buses.

Paul Soubry^ So the first question or the first -- you talked about was I think your words were a redesign of the battery container or whatever to put the cells in a reminder of what happened there.

We historically would buy modules that have been packaged -- the cells have been packaged by a third party.

Then we would embed them in some kind of a container.

Internally, we call it a juice box.

We make ours out of a fiberglass container.

And inside that container are a series of battery modules, that have also cooling going through there or heating depending on the operating environment, those patterns are working in.

What we found out, not just us, but every one of our competitors in the vast majority of the industry is there is a potential for the cooling system to have leaks inside those battery containers or again what we call a juice box.

And if there is a leakage of cooling inside there, there is a possibility of a thermal event.

So what we decided to do was to embed some kind of a valve, if you will, that if there was a fluid inside the container, the valve would open up and it would eject the fluid from that thing and therefore minimize the potential of a thermal event.

So we did two things.

We retrofitted the fleet that was in service, and then we made that as a standard part of our design of the vehicle.

The other thing that we've been doing on batteries going forward is we've been trying to know we're not trying.

We are actively and have had multiple source of battery providers.

For the first six or seven years of New Flyer's maybe eight years of New Flyer battery or fuel cell deliveries, we only had really one battery supplier.

We now have two active battery suppliers with two different types of batteries, all inside a similar juice box container.

So we now have options not only to have some price leverage, if you will, or competition among our suppliers, but also to build redundancy into our supply chain if there are any problems going forward.

That's in the North American environment.

In the U.K. environment, our Alexander Dennis designed and built chassis have batteries that are provided as full contained units from a third party that is based in Poland and those that company builds for a number of other manufacturers.

We are actively and in process of setting an alternate supplier for the Alexander Dennis battery supply as well.

So as this thing evolves, the key most expensive component of any zero-emission vehicle is the batteries or in the case of a fuel cell a fuel cell device.

And so we're continuing to learn from product service.

We're continuing to trying to build redundancy into those things.

So that's what we're really working on. The other dynamic that is probably the most complex on a zero-emission vehicle when you get past things like the battery or fuel cells is the electrical architecture. The complexity of the wiring harnesses in the electrical system goes up exponentially compared to a diesel vehicle.

And we are continuing to work with alternate supply and advanced design companies to continue to improve those things, just like any product would continue to improve over time.

We're seeing improved reliability.

We're seeing better costing. We're seeing competitive tension from suppliers. This is what we do all day long.

So we're quite pleased that's not -- those products are not without challenges and risks, but we're really starting to see both adoption rates go up and performance and readiness and reliability improved in the field.

Tamy Chen^ And could you just talk about the cash cycle for the EVs?

Paul Soubry^ Yes. So the second part of your question, the cash cycle.

So Brian alluded to this, and I commented a little bit One of the dynamics when we first got into ZEBs we had battery providers wanting us to pay them in advance of us building the vehicles to either secure the batteries upfront or to buy the batteries or secure the capacity or by the batteries.

We also saw customers taking longer to accept and inspect those vehicles. The discussion that we've had earlier about embedding milestone payments and contracts is mitigating some of that long cash cycle.

We had hoped the industry would adopt a standard milestone payment schedule that has not happened.

Every customer has a different milestone payment schedule.

We are getting more professional, more aggressive in our proposals of giving a fair price, giving a balanced product, and exceptional service and so forth, but also being aggressive at our ask for milestone payments.

We are dealing with government purchasing agencies, and so it's a negotiation, but we are pleased at the rate of acceptance, as I said, on the historical contracts we had and we have been pretty aggressive on our ask and our proposals going forward to reduce that overall cash cycle.

That's why Brian was alluding to.

We've got about a $40 million net benefit so far this year on milestone payments and we will see that to increase over time as misleads become part of every contract, whether it's diesel or ZEB contract.

Operator^ Our next question comes from Daryl Young with Stifel.

Daryl Young^ Congrats on the good quarter. Just wanted to touch on coach demand at ARBOC demand. You called out some pretty strong numbers.

I think it's probably recovering faster than any U.S. would have expected at the depths of the pandemic.

So -- can you maybe just give us a bit of color here on where the coach demand is coming from?

Is it travel trends and to our operators or anything there?

Then historically, I think Coach has been the higher-margin product of the two.

Is that still the case with all the changes that have happened in the last couple of years?

Paul Soubry^ It's a good question.

Of course, it's not really well detailed in our analysis or MD&A. Just some context, Daryl, for a reminder, pre-Covid or when we first -- MCI become part of the family, we used to think about 60% of that business was private operators and 40% of it was public operators. When Covid kicked in and all of these coaches were parked for a number of periods, we didn't build a private motor coach for probably 2.5 years.

Then we started that line back up, and it has recovered very well.

There was a rationalization in the private motor coach industry. There were some bankruptcies. There were some acquisitions by larger operators of other operators and so forth. When we go to the trade shows, we go to see our customers, the rate that we're building MCI private coaches is now getting back up to in the neighborhood of 400 or so units a year.

It's not really back up to maybe 600 or [where] it was at that time, but it has recovered probably faster than we thought. The government dynamic on motor coaches is very lumpy because it's a number of large agencies like New York, Dallas, Houston, New Jersey that buy in batches.

There's been a bit of a low of the public motor coaches for a while, but there's some good contracts that we've either won or that are in active procurement right now.

So we're quite pleased that the recovery of the MCI business overall.

We've invested about $10 million in that facility over the last year in a complete overhaul of the building in Winnipeg that allows us to build motor coaches on a common line, which will give us some purchasing efficiency, some labor productivity and so forth.

So that's motor coach.

On the ARBOC dynamic, it is historically a low floor cutaway business, where we build a body and integrate that on top of Ford or [GM] chassis. That market has recovered very well.

Today there's only ICE engines.

The demand of that market and the backlog of ARBOC is well into, gee, almost the end of 25 or maybe 26% in terms of sold slots.

It's really strong.

And we have increased that business production rate sequentially every quarter for the last year or so, and we think there's more opportunity to do so. The other part of ARBOC was the introduction of medium class vehicles, both ICE vehicles, we call the brand Equess or zero mission.

The ICE -- original design of ICE had a little bit of challenge in the marketplace and demand slowed down, although we still think there's an opportunity for that business to grow.

We offered a zero-emission vehicle that has not really had that much take-up, but we still believe that the cutaway market will support the ARBOC business plan for years to come and that there is upside as we continue to investigate the medium-class vehicle, specifically in zero emission.

Operator^ Our next question comes from (inaudible) with CIBC.

Unidentified Participant^ I was just wondering on the ZEB deliveries this year, obviously it's a pretty significant ramp-up that you're guiding to in the back half. Do you have concerns around reaching that 30% target just given the supply chain issues, maybe you're seeing specifically related to that?

Paul Soubry^ Look, there's always risk on the supply chain. Quite frankly, if we didn't have any supply chain challenges, we could ramp up the ZEBs contractually dramatically faster -- people skills, train skills is obviously an issue, but the supply chain is the governing factor.

So we've guided to -- for the second half of the year to the rates that we put out. Every one of those slots is sold.

We know which customer we're selling and building for where we can, we've laid in advanced inventory or redundant inventories earlier than we've had in the past.

It's a custom-made product that has both technical complexity and then inspector or customer complexity and acceptance and dynamics.

So there's always risk in that.

We've given a full year range that we think has enough room to be able to handle both upside and downside risks.

We're crazy deep in managing the supply chain with our vendor development team, whether it's an ICE plus or a zero-emission vehicle.

At this point in time, we're comfortable with the rate that we've put out there for Q3 and Q4.

Unidentified Participant^ Okay. Great. And maybe just further on the supply chain.

Is it that maybe you're just waiting an extra few days or a week for a part?

Or do you have some buses that are just sitting there and you don't know when that one part might show up?

Paul Soubry^ So we got a -- this is in automotive.

As you know you've been and you've seen we have a very sophisticated ERP system in the factory.

We have customized bill of materials that have been signed off by the customer before we start the build.

We have a very sophisticated vendor management system.

We have some suppliers that have shortened us by supplying a part on a date that they had proposed to supply it to us.

And so because we historically had just-in-time inventory or point-of-use inventory, when you don't have a widget to put on online, it has massive implications.

We continue to adjust the production schedule as best we can.

But it's not like we can just stop building order A and build order B because all of the materials are bought for a specific customer.

We're working incredibly hard to manage those customers. Two examples I gave you.

One is wiring harnesses -- or I gave one of the guys earlier -- wiring harnesses.

We have kind of four major vendors.

We've added another one. And quite frankly, we've in-sourced some of that to our own manufacturing capability to build redundancy in the wiring harness system.

Now in '22 and '23, we made the decision to line enter buses where we knew the wiring harness was not coming on time in the hopes that we could catch up.

The downside of what happened there is that we had way too many rectification hours and we had too many dollars tied up in work in process. The decision we've made this year is if we know there's a part not coming that is that critical like a wiring harness, we're not inducting the bus.

So that's a big change in our operational strategy.

So the supplier says he is supposed to have it on Monday.

He now says Thursday we're trying to manage our way through their performance to their promises.

If it's a part like a seat, for example, that's our other major part right now.

We have a U.S. supplier that is really struggling to make the seats and delivered on time.

We'll still induct those buses, but we're installing those seats offline, and we're, quite frankly, charging back to the supplier the extra labor to do so, which we never did before in the past.

It'd be really hard to be generic about is it a day or two days or a month from when we get those parts.

We don't have buses line around for long periods of time.

What we're trying to do now is mitigate or govern the line entry of vehicles rather than trying to deal with it off-line downstream like we did in the past.

Unidentified Participant^ Okay. Great. That makes a lot of sense. And maybe -- on the debt backlog, I believe you said 41% of your backlog is now.

Is that split similar if we were to just look at the firm orders?

Or do you find the [ZEB2] options?

Paul Soubry^ It's probably higher in the options.

Of course, that's just the nature of the big orders that we've seen in the last little while. The first year is firm and then the multi-years are options.

I would suggest that as we get through ‘24, ‘25, ‘26, where we continue to see that percent ramp up, it's a prior -- probably a higher percentage in the auction world than it is.

I don't have the data right in front of me.

Stephen King^ But just a reminder, [Christa], that everything that Paul mentioned around 2024, what's in our plan is in our backlog today.

So that -- those orders would be in the firm back.

Unidentified Participant^ Okay. Perfect. Congrats on the quarter.

Operator^ This concludes the question-and answer-session.

I would now like to turn it back to Stephen King for closing remarks.

Stephen King^ Thanks, [Shawn].

I did have one question through the web chat, and this is one for Brian from [Jim Barlow] and you kind of answered it earlier, but it out here, how do you hope to reduce debt and increase funding to capital investments?

Are you considering issuing debentures for private investors?

Brian Dewsnup^ Okay. Thanks. Great question.

So as we mentioned earlier, we would expect to be able to fund and we project to be able to fund all of our capital spending and working capital increases from that matter through just normal company cash flows and normal activities.

We do not expect to have to go out and raise increased debt balances or issue equity in order to fund those aspects of the company.

So we feel comfortable as we projected out the back half of '24, '25 and '26 that we'll be able to fund all that with our cash flows.

Stephen King^ Great. Great. Thanks, Brian. That puts an end to our conference call. Thanks, everyone, for joining.

As always, please reach out if you have any follow-up questions, all of our contact information is on our website.

As well, all of our financial information is there, our ESG information and our supplemental financial package, which we hope helps people as they're doing analysis on the company. Thanks, everyone, and have a great day. Talk to you soon.

Operator^ And this does conclude the program.

You may now disconnect.