DOWLAIS

DOWLAIS GROUP PLC
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TRANSCRIPT

Dowlais

Liam Butterworth, Chief Executive Officer

Roberto Fioroni, Chief Financial Officer

Chris Dyett, Investor Relations

Questions From

Vanessa Jefferies, Jefferies

Mark Davies Jones, Stifel

Mark Fielding, RBC

Michael Jacks, Bank of America

William, Exane – via webcast

José, JP Morgan – via webcast

Sanjay, Citi – via webcast

Introduction & Key Highlights

Liam Butterworth, Chief Executive Officer
So, good morning everybody, many thanks for joining us today for our Inaugural First Half Results. I'm Liam Butterworth, the CEO of Dowlais and for those who do not know me, I have spent over 30 plus years in the automotive industry, and was the CEO of GKN Automotive from 2018 until the demerger.

It's great to be speaking to you today about what the Group has achieved and the exciting future that we have ahead of us. In terms of the agenda for the morning I'm going to start by taking you through the half year highlights. I'll then provide an overview of the key achievements for the Group, including an update on our sustainability strategy. Roberto will then present the first half financial performance and guidance. Following this I'm going to take you through the performance of our two market leading businesses GKN Automotive and GKN Powder Metallurgy. I will then conclude, after which we can take some of your questions.

So let me start with the first half highlights. Dowlais has delivered very strong first half performance, making significant financial and strategic progress against the goals we outlined at the Capital Markets Day in January.

Due to the impending UAW strike, which provides a certain level of uncertainty for the second half we are not changing our expectations for the full year.

Our focus has been on three key areas, margin expansion, cash generation and portfolio transition, all of which are well ahead of expectations in the half.

So first of all margin expansion, whilst our revenue in constant currency grew by 10% year on year, our operating profit in absolute pounds grew by 40%, which resulted in 140 basis points of margin expansion, albeit from a softer first half 2022 comparable. This is an outstanding achievement and once again we have fully offset inflation right across the Group.

Secondly, cash management, we are very pleased with our cash performance whereby we generated £33m of adjusted free cash flow during the first half, again ahead of our expectations. And this has improved our net debt and reduced the Group's leverage to 1.4 times, from the 1.5 times at the date of demerger.

And finally, portfolio transition, we continue to make great progress as we transition our portfolio to capture profitable growth from the shift to electrification. And of note, Automotive has secured record bookings and an eDrive programme at target margins. And Powder Met has also grown bookings and secured its first commercial agreement for permanent magnets.

On slide 5 we reinforce the highlights from the first half, starting with GKN Automotive. Operating margin increased by 270 basis points year on year with a 92% profit growth. Automotive has secured record bookings of over £3bn of lifetime revenue in the period. And this is a book to bill ratio greater than 1.3 times. Significantly, these bookings, 78% of which are on EV platforms have been realised across its entire portfolio of products, customer groups, and geographies. And this further reinforces our confidence about the future for the Automotive business.

The Powder Metallurgy business is doing better in recent months as well, after what was a challenging second half of 2022 and first quarter of 2023. This led to an 80-basis point improvement in the first half operating margins when compared to the second half of last year. And this was even better sequentially in the second quarter. This has been driven by improved operational performance following the resolution of some operating challenges it experienced in the US.

It has also seen strong progress on new business bookings with a 36% increase in the first half compared to the prior year. As it works on transitioning its portfolio, it is now seeing momentum in bookings for EV applications which it continues to be heavily focused upon.

And finally, as I've already mentioned, we're extremely excited that the Powder Met team has secured its first commercial agreement for permanent magnets, well ahead of plan and that is with a major global Tier 1 automotive supplier.

As we outlined at our Capital Markets Event in January, sustainability is very important to us, and our goal is to contribute to a cleaner, more sustainable world. With this in mind we set out our sustainability commitments for the year and we have made great progress against those. Based on double materiality we are track to develop our Group sustainability strategy and we will also submit net zero science-based targets for validation by the end of 2023 for both Automotive and Powder Met.

We have established a Group Sustainability Management Committee, which I chair, and we will use this forum to drive progress throughout the Group. And within the business we continue to make progress. For example, this year Powder Met achieve and EcoVadis silver rating and Automotive is currently evaluating a power purchase agreement for renewable electricity for its European operations.

Finally, we are on course to publish a consolidated sustainability report alongside our 2023 annual report. This will contain significant new information including new targets based on the materiality assessment that we are currently conducting.

I am now going to hand over to Roberto who will take you through the financial highlights.

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Financial Update

Roberto Fioroni, Chief Financial Officer
Thank you, Liam. And good morning everyone. For those of you who I haven't met yet, I'm Roberto Fioroni, the Dowlais CFO. Today I will be walking you through the financial performance for Dowlais for the first half of the year.

On slide 8 we showcase the headline results for the Group and for the avoidance of doubt these results are for the whole six-month period, January to June 2023.

As you can see revenue grew 10% on a constant currency basis while operating profit grew 40% in absolute pounds. This clearly demonstrates the effective execution of our financial model.

Incremental revenue in the period dropped through at 35%, excluding central costs. This impressive operating leverage is the consequence of the Group fully offsetting inflation, improved operational performance and the continued benefits of our restructuring programmes.

The drop through rate in the period was higher than our medium-term guide of 30%, also because of softer prior period comparables, as such, and in line with our plans, we expect drop through margins to be lower in the second half of the year as comparatives strengthen.

The 140-basis points margin improvement on the prior year includes incremental standalone Plc costs for the first half of 2023. Excluding these costs, in order to get a better reflection of the underlying operational improvement, margins expanded 190 basis points and operating profit grew by 52% in absolute pounds.

As highlighted earlier by Liam, the Group's relentless focus on cash delivered an adjusted free cash flow of £33m. Finally on this slide I want to highlight our inaugural dividend of 1.4 pence per share, which is in line with our stated capital allocation policy.

The Board approved an appropriate dividend that we believe provides the right balance between returning cash to shareholders and de-levering our debt and reinvesting in the Group for future growth.

Moving to slide 9 we show our revenue growth by key driver and relative revenue share by geography. Starting with the key drivers of revenue.

Volume was the major contributor, driving £183m of year over year revenue increase. This is the result of the strong growth in the global light vehicle production market.

Price drove an increase of £62m in the period, this is the net of contractual annual price reductions, standard in our industry and the customer inflation recoveries. Similar to the prior year we continue to recover more than 70% of inflation via customer pricing. Together, volume and price resulted in a 10% growth versus H1 2022.

Finally, foreign exchange provided a benefit versus prior year. Geographically the Group's revenues continue to be well balanced, mitigating any risk deriving from over exposure to a country or region.

Lastly, we continued to serve a broad customer base the includes pure EV manufacturers and Chinese OEMs.

On slide 10 we show the year over year bridge that explains the £50m operating profit growth versus the prior period. As this is the first time we have showed this chart I will carefully explain the key drivers.

Volume, this is the operating income generated from volume growth at prior year contribution margins. Volume drove a £53m increase in profit versus the first half of the prior year.

Secondly price, this column is the sum of three factors; the standard annual contractual price reductions, direct and indirect material year over year inflation impact and customer price recoveries to offset inflation. This translated into a slight headwind of £4m versus the prior period.

The third column, performance represents the benefits that are delivered via continued operational efficiencies and prior year restructuring. Labour inflation is also accounted for in this column.

Performance in the period provided a £17m benefit versus the same period last year. As we execute our financial model you would expect the sum of price and performance to be positive when added together. This is the case for the first half of the year with a £13m improvement versus prior year.

Finally, we incurred £15m of central costs in the period. These incremental Plc costs are in line with the previous guidance.

Slide 11 provides more detail by business unit. As a reminder the year over year comparisons are at constant currencies.

In Automotive revenues grew by 12% and margins expanded by an impressive 270 basis points, as a result of higher volumes, operational performance and fully offsetting inflation in the period.

In Powder Met revenues grew by 2%, including the impact of customer recoveries to offset inflation.

Margins contracted by 110 basis points as a result of a one-off issue in Q1 this year and some operational performance challenges in North America. I will talk more about this on the next page.

Finally, we continue to make progress in the Hydrogen business, we currently have 17 operational systems with a further two that are in the process of being commissioned. The prospects for this business are promising and we believe they could be accelerated through a strategic partnership. Therefore we have initiated a process to assess opportunities and we will update you in due course.

On slide 12 we take a deeper dive on Powder Met's recent margin performance. Powder Met is a great business with exciting prospects which has not performed to its full potential over the recent periods due to operational efficiencies driven by one off events. These events impacted margins negatively in the second half of 2022 and in H1 2023, as can be seen on the chart.

Despite these challenges we have many reasons to be optimistic about the business. Firstly, our H1 margins expanded by 90 basis points on a reported basis, versus H2 of last year.

Secondly, in the first half of this year the business has managed a further step up in performance as Q2 margins were sequentially higher than Q1 by 170 basis points.

Finally, the Q2 margin was higher than full year 2022, also as a result of healthy volumes. As such, Powder Met is back on track to flow incremental volume to operating profit at the expected drop through margins of approximately 30%.

Moving to slide 13, I want to discuss cash. As you know we are relentlessly focused on cash and Dowlais is cash generative. The table on the left of the page splits the £313m of cash flow we generated into the two main sources, EBITDA and dividends from our JVs.

The chart in the middle shows a relative view of the uses of cash that amount to £280m for the period. The key highlight is that we have generated adjusted free cash flow of £33m, while absorbing the seasonal buildup of working capital, as well as the significant levels of investment in capex and restructuring to support future growth and productivity. A major part of which is a result of Automotive's footprint expansion in best cost countries.

Improving profitability and rigorous cash management has enabled the Group to de-lever since demerger. We remain focused on cash generation, which is a strategic priority for us, we are very satisfied with the strength of our balance and at the same time remain mindful of the macroeconomic environment and sector dynamics. Simply said, we are balancing our commitment to maintain a solid balance sheet, whilst returning value to our shareholders.

The dividend announced today is a good example of our thoughtful capital allocation strategy.

Finally, on slide 14 we are giving you some technical guidance to help with your modelling. I am not going to go through each point as it largely reflects what we communicated to you in January during the Capital Markets Day. One of the items I do want to highlight is the effective tax rate. In 2023 we expect this to be between 25 and 26% as we work through finalising positions post demerger. I expect this to reduce in future years.

Thank you. And I will now hand over back to Liam.

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Business Update

Liam Butterworth, Chief Executive Officer
Thanks, Roberto. I'm now going to talk in a bit more detail about the first half performance of our two core businesses.

The Automotive business made excellent progress against all its strategic objectives, with revenue growth of 12% to £2.3bn, driven by volume and pricing recoveries. Importantly this led to a significant margin growth of 92% versus the prior year, which is an expansion of 270 basis points to 6.5%.

I should clarify that H1 2022 didn't have the benefit of the pricing recoveries that we realised from the second half of 2022.

The business, as previously, continues to fully offset the impact of inflation through multiple levers, including commercial recoveries, procurement efficiency and plant productivity. I'll cover this in more detail on the next slide.

It has also made outstanding progress in securing new business in the period, where it has secured new contracts with a value of more than £3bn of forecast lifetime revenue and this is another strong period with orders running well ahead of revenue and therefore giving us confidence in its long-term growth prospects.

Margin expansion is a critical element in its strategy, therefore I wanted to breakdown the drivers of margin improvement for Automotive in the first half of the year. As you'd expect higher volumes have resulted in an improved margin given the drop through and this will continue to be a key driver for future margin expansion.

Direct and indirect material inflation have all successfully been offset thanks to their ability to recovery price from the customers as well as procurement productivity. And labour cost inflation has also been more than offset thanks to continuous improvement programmes, as well as the incremental benefits they are seeing as a result of the ongoing restructuring programmes.

So overall this has seen the margins rise by 270 basis points year on year and the financial model for the Automotive business is extremely resilient and this is what gives us absolute confidence in their ability to achieve double digit operating margins.

On slide 19 we wanted to give you an update of the ongoing work to optimise the Automotive's manufacturing footprint. It has got three major footprint programmes, two of which are in Mexico and one greenfield site in Hungary and all progressing in line to plan and to budget. And these programmes will add a further 57,000 square metres of best cost country manufacturing capacity, starting with the opening of Hungary this month.

And these programmes will then enable the Automotive business to reach 60% of its operational headcount in best cost countries over the medium term.

On slide 20 I wanted to highlight the tremendous half the Automotive team has had in terms of new business wins, where they have booked over £3bn in lifetime revenue which results in a book to bill ratio of 1.3. Of the £3bn of bookings more than £2.3bn have been awarded on EV programmes, all of which are at or above target operating margins. And this booking performance also confirms that the business is achieving at least the same market share on EV platforms as the one it has on ICE platforms. So this is further evidence of how the business continues to benefit from the shift to electric vehicles.

Slide 21 shows the breadth of new business wins Automotive has achieved across the portfolio. New business bookings have been secured at target margins across multiple customer groups, in all regions and the entire portfolio. And we are pleased to announce the major eDrive system win in the period, launched in 2026. And this is a programme that supports our margin expansion objectives and is fully aligned with our business strategy. This is a further demonstration of the market leading position Automotive has and a reflection of the breadth of technology, quality, operational excellence, and competitiveness it has across the entire portfolio.

In summary Automotive has had a fantastic start to the year and continues to reinforce our confidence in the outstanding quality of this business.

Powder Met revenues were up 2% versus the prior year, which reflects 1% lower year on year volumes, more than offset by price increases. The operating margin achieved for the period was 9.2% and Roberto has already explained the dynamics behind this and how we're very optimistic about the future performance.

In the period inflation related impacts were fully offset by customer recoveries and operational efficiencies. And from a commercial perspective it was a successful first half with a 36% year on year growth in new business wins. And importantly 75% of the value of these wins were from propulsion agnostic product groups.

Also, as I mentioned earlier, a notable development was the confirmation of its first magnets commercial agreement, secured with a leading global Tier 1 automotive supplier. This agreement is an extremely promising milestone for the business, as it seeks to establish itself in the rapidly growing permanent magnet market.

Slide 24 looks at Powder Met's bookings in the first half in more detail. It is clear that Powder Met's portfolio strategy is progressing extremely well, with three quarters of new business bookings dedicated to propulsion agnostic components in areas such as differential gears for eDrive systems, steering pullies and part brake gears.

And in line with its commercial strategy all of these new business wins are consistent with its target operating margins to support long term profitability growth.

On this slide we have separated the Powder Met portfolio into its various product segments and show how they will be impacted by the transition to EV. As expected, some of the more traditional ICE specific products in the engine and transmission space will gradually decline. We are confident that this will be more than offset by profitable growth in several product groups where Powder Met is seeing increased momentum for applications on BEV platforms such as differential gears, suspension, steering components, all of which have performance requirements extremely well suited to sintering technology.

And additionally it has also secured two exciting new product areas, iron powder for LFP batteries and permanent magnets where there is significant future growth potential.

On slide 26 we demonstrate concrete examples of recent wins on BEV platforms across non-ICE specific product groups. And as you can see Powder Met is securing programmes on a wide range of applications such as differential gears, thermal management, x-by-wire, and batteries.

The differential gear programme secured for a large US OEM is actually the single largest contract that Powder Met has ever secured. The content per vehicle can be up to £40 across the product group. And this is a great example of how the benefit of sintering technology can be applied for BEV platforms.

And another example outside of magnets is iron powder for LFP batteries. Powder Met is already supplying substantial quantities of this material to a leading Chinese battery manufacturer and is now seeing a significant volume of enquiries as the market looks to increase the share of LFP battery technology on smaller sized lower cost vehicles.

On slide 27 I wanted to provide more detail on the magnet market and how Powder Met is gaining momentum. The market for rare earth magnets specific to passenger cars is forecast to grow from 17,000 tonnes in 2023 to 42,000 tonnes in 2030. And it is becoming increasingly apparent that the demand for regionalised manufacturing sources in Europe and North America is growing and we are seeing a significant increase in customer interest, both from Tier 1s and OEMs.

Powder Met has been actively defining and implementing its strategy to participate in this growing market. And has successfully secured a commercial agreement with a leading Tier 1 auto supplier.

The next stage of its development in this market is to ramp up production over the next 18 months or so, as well as securing the right relationship throughout the entire supply chain from mine to magnet.

So we are extremely excited about the future opportunity that this presents for us.

So to sum up Dowlais has had a very strong first half, beating our expectations and demonstrating that we are successfully executing our strategy, significant margin improvement, cash generation, and managing the EV transition with record bookings at target margins.

Clearly the impending UAW strike provides a certain level of uncertainty for the second half, which we will navigate successfully given our operational and financial track record. So as such we are not changing our expectations for the full year.

With that we'd be happy to take any questions you have. So please state your name and affiliation for the call that is now being broadcast. Thank you very much.

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Questions and Answers

Vanessa Jefferies, Jefferies

Morning, congratulations on some great results. I know it's really hard to comment on the UAW strike, but is there any kind of range that you could give us – like impact per month of shutdown?

Secondly, good to see really strong EV bookings in the Auto business, are you expecting a kind of even first, second half weighting like last year for total bookings?

And thirdly, on the eDrive systems award, maybe could you give a little bit of detail on what kind of profile of award you're looking for in eDrive systems? And how you're achieving those target margins on that one?

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Liam Butterworth, Chief Executive Officer
Okay, I thought it was one question, that was three. If I take the eDrive …

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Roberto Fioroni, Chief Financial Officer
And I take the other two?

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Liam Butterworth, Chief Executive Officer
You take the difficult ones. On eDrive we have said we have an extremely strong and deep technical capability in all wheel drive systems and eDrive and we have demonstrated that in a number of programmes that we have in the market. We have been supplying over two million of these units.

We are not going to chase volume in this space because we want to make sure that we recognise the value of the technology and engineering capabilities that we have across gearboxes, inverters, and motors.

As such the eDrive programme that we have secured is for a niche high performance SUV programme. It has got a significant amount of additional content in terms of eDrive technologies, and it has been secured at target margins and the customer has made a significant contribution to the capital and the engineering cost to develop it. So it fits certain in current terms of the portfolio that we want to develop and take to market.

And I think we have said in previous conversations that we have actually walked away from a couple of eDrive programmes last year. And you know if I look and hear what's in the market, I am extremely grateful that we did walk away from them, because I think I'd be struggling to deal with that – the financial situation of those programmes.

Sorry there were two other questions, the UAW one you're going to take.

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Roberto Fioroni, Chief Financial Officer
Bookings and UAW.

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Liam Butterworth, Chief Executive Officer
Bookings, so bookings tend to be lumpy. You know we have a big eDrive programme that was a significant portion of the £3bn in the first half, although it was across the entire portfolio. So the second half, you know we'll see, but we're already making it – we have had a very good start to the second half, and we are confident that we will exceed our book to bill ratio for the full year.

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Roberto Fioroni, Chief Financial Officer
And exceed prior year bookings.

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Liam Butterworth, Chief Executive Officer
Sorry, yes.

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Roberto Fioroni, Chief Financial Officer

So setting a new record I guess on bookings. On UAW, Vanessa, you tried this this morning as well and we're going to go around and round on this one. Look, we don't have a crystal ball, so obviously the strike, if there is a strike, it is going to depend on how broad it is, meaning one OEM or three OEMs, some people say there might even be targeted suppliers and then the duration.

All I will say is from our perspective our exposure to the D3 sales on an annual basis is – in North America is about 15% of the Group's revenues. Obviously, the majority of that – it's very easy to link for Automotive as we supply OEMs directly, not so clear from a Powder Met perspective we're a Tier 2 supplier, so we don't necessarily know where the Tier 1 eventually sells into. But you know that's approximately our exposure – is 15%.

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Liam Butterworth, Chief Executive Officer

So I just want to add to that, so clearly, it's a very volatile situation at the moment and there are lots of moving parts, every day we are seeing different levels of communication coming out. All I can say is we have a fantastic operational team in the Automotive and the Powder Met businesses. And if you look at what the teams have navigated over the last four years, whether it be COVID, semi-conductors, barges blocking the Suez Canal, it's another challenge that we have deal with. You know we have got a very strong muscle in dealing with operational challenges and we'll work our way through it.

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Vanessa Jefferies, Jefferies
Thank you.

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Mark Davies Jones, Stifel

Two please, one very broad and one rather more specific. The specific one is around your Chinese business and how well you're positioned if those Chinese OEMs move progressively into Europe, which seems to be scaring the Germans rather badly at the moment. Would you be a net beneficiary of that? Is your scope of business with them as broad as it is with the Western vendors?

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Liam Butterworth, Chief Executive Officer

Yeah, so we have a fantastic relationship with our – our JV partner HASCO we have been with them – in fact I think it's the 30th anniversary next week, we've been with them for a very long period of time. A great relationship with them and very well balanced across the globals and domestics. About 40% of our revenue in China is with the local OEMs and 60% is with the global.

We are – and you know we spend a lot of time, the commercial team in terms of what is the commercial strategy going forwards to make sure that we, again, profitably grow with the Chinese OEMs and we are winning with the successful OEMs at margins that are in accordance with the target margins for the Group.

We have a very clear strategy in terms of how we'll support those OEMs as they come out of China and expand globally their footprint into Europe and South America. So we feel that we are well positioned and that you know we have a very good relationship with our JV partner, and we are fully aligned in terms of it is about profitable growth, not just taking market share for the sake of it.

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Mark Davies Jones, Stifel
And how does it work if the Chinese suppliers come out of China, is that still served via the JV or is that direct then?

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Liam Butterworth, Chief Executive Officer
So we – everything that is supplied in China from the Dowlais – or sorry from the Automotive business is through the JV. So it is our product and it's our technology. And that will go with them as they come out of China.

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Mark Davies Jones, Stifel
Thank you.

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Liam Butterworth, Chief Executive Officer

We think it's – clearly you know we need to be competitive, but we clearly – based on the breadth of portfolio we have, the quality, the productivity, the cost competitiveness we are confident that we will be able to support them wherever they go with their manufacturing footprint.

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Mark Davies Jones, Stifel

Thank you. The broad one was what you think is going on in the broader auto market in terms of production volumes overall. I mean take the strike out of it, we've obviously had a very strong first half, there has been some catch ups and deferred spending there. Some of the leading indicators, I mean the German IFO for the auto sector is worse than it was at the GFC, people are expecting a pretty drastic slowdown, but that's not the tone you're getting out of the OEMs. So what's your take?

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Liam Butterworth, Chief Executive Officer

I can't forecast auto volumes, but we use S&P as our forecasting house and to be honest I can't give a better forecast than what they say. You know we think next year there will be some growth, although it will be relatively moderate. I can't really say much beyond that. You know we're continuing to look at what's happening with underlying demand versus inventory. Inventory levels are a key proxy for us to see what's going on as well as discounting in the North American market. And we see there is still a lot of discipline in the market as a result of that. So you know we're well positioned globally and we're going to make sure that we keep a close eye on it. But for the time being we see that demand is relatively stable.

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Mark Davies Jones, Stifel
Thank you.

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Mark Fielding, RBC

Hi, a couple of questions please. Firstly, just following up a little bit on the eDrive system win, could you maybe talk a little bit more about what you think specifically differentiated you to win that? And then what's the pipeline like in terms of other similar opportunities or is this something we can be expecting one or two a year, or is it going to be more intermittent? And then in that context, the final bit – it's a long one question, isn't it? Obviously at present you buy in parts of that, and you said you know you'd think about that in the future, what's the tipping point where you think about more you know make versus buy in that business?

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Liam Butterworth, Chief Executive Officer

Yeah, so in terms of what differentiated us on that programme, so an eDrive system, it's not just a case of screwing a few parts together, it's a very complicated system, when you bring the motor, the inverter, and the gearbox together. And then all the software associated to make the system function as a very high performing unit. The OEM that we are working with had been burnt actually working on another programme with another supplier, and they wanted a supplier that could basically take responsibility for designing and developing the full system and they could be assured that when it goes to production they are not going to have any issues.

I think that is one of the strengths that GKN has, is just our extensive knowledge and expertise across the whole systems integration piece of an eDrive unit. And we have demonstrated that with the VW

programme that we're launching next year and over two million units in the market and another programme with the Fiat 500e which is continuously growing and being successful with that customer.

Now in terms of our strategy, we have been very clear that our core business is the hard parts, the gears, and the integration of that system. For motors and inverters we have a very clear buy strategy. With motors we are buying sub-assemblies and actually doing that assembly ourselves.
Do we intend to further vertically integrate in motors? At this point in time, probably not, because we believe that there is so much capacity being installed globally for motors that we can probably source them at a very competitive price. And for inverters and electronics we will never go into electronics manufacturing, there are contract manufacturers out there that will build to our design and our print and that is our strategy going forward.

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Mark Fielding, RBC
And just in terms of the possible pipeline for similar types of business?

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Liam Butterworth, Chief Executive Officer

Yeah, so again we're not chasing kind of three or four a month of these programmes, they take a significant amount of engineering resource and effort to secure a programme. So I would say you know one to two a year is kind of where our target would be. But if it's not then you know again, we will be only focusing on programmes that are profitable. We are not going to be booking these for the sake of it.

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Mark Fielding, RBC

Great, thanks. And then my second question after the very long one question was a - hopefully a short one. How do we think about price cost outlook as we move into 2024 now, it's obviously been a bit exceptional over the last year or so, just what do you think is more normal ish?

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Liam Butterworth, Chief Executive Officer

We have said and maybe speaking a little bit under your guidance Roberto – maybe you go.

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Roberto Fioroni, Chief Financial Officer

Our financial model is very clear, right. We are going to fully offset inflation and in a, I don't know what a normal year is anymore because I don't think we've had a normal year for the last five. But if you go into a year where there is no hyperinflation, which I think is what you're indicating, you know we still have those annual industry standard price reductions, you know contractual price reductions, which are quite modest in our case, and we are committed to offsetting those with direct material productivity. So that would be a standard model. In a year of inflation we obviously go back to the customer base and ask for support and then we ratchet up on the self-help. But expect cost price to be neutral in the long run.

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Liam Butterworth, Chief Executive Officer
But you know we've had very sensible conversations with all of our customers over the last two years as we have gone through the inflationary challenges. And I think I've said this before, one of the strengths of this business is just the market share that we have and the breadth of capability that we have, the OEMs listen to us because they need us. And the way we've supported them through COVID and all the different operational challenges the industry has been through we have had no customer disruptions at all. So we have very, very good intelligent open conversations with our customers and they have been fair with us, and we've been fair with them.

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Mark Fielding, RBC
Thank you.

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Michael Jacks, Bank of America

Good morning, thanks for taking my questions. The first one, you gave us some great granularity pre demerger on the subcomponent systems within the Automotive business, could you perhaps give us some sort of sense of what proportion of the order intake came in eDrive and related standalone components in the first half?

And related to that, how do we think about growth in this subsegment relative to global EV penetration? That's the first part of my question.

And then secondly, I appreciate the high drop through rate guidance that you have given us midterm, but could you give us a sense of what proportion of that comes from incremental cost savings which I guess stem from the restructuring that you've been implementing? Thank you.

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Liam Butterworth, Chief Executive Officer

So I'll take the portfolio. So the portfolio, we don't breakdown bookings by product line or category within our new business wins. All I can say is it's across the entire portfolio. You know we've been very successful in side shafts, in eDrive systems and eDrive components and we are very happy with how that is spreading across.

And we are also mindful of in terms of when we're pursuing – you know we look at the commercial strategy for the business and when we're pursuing programmes that we've got the right allocation of engineering resource across the portfolio. So all I can say is it's very well balanced across the Group.

Secondly in terms of growth, you know we have clearly said the number one priority for Dowlais is margin expansion, not growth. We have said at a high level that this business will grow at, or slightly above light vehicle production. Now if there are opportunities to accelerate that growth profitably, then that is exactly what we will do. But we will not be chasing volume for the sake of it.

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Michael Jacks, Bank of America

Sorry, thank you for that. Just to be clear is that in relation to the EV powertrain component, or is that Automotive as a whole?

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Liam Butterworth, Chief Executive Officer
Automotive and Powder Met as a whole.

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Roberto Fioroni, Chief Financial Officer

On the drop through margins I guess you know let's look at them by business. Overall the Group had 35% in the first half. And as I said you've got to keep in mind there was some softer comparables in Automotive. So Automotive was actually higher than that and I wouldn't expect that in the second half to be sustainable, just because prior year comparables were softer as we hadn't recovered inflation yet, but we had the inflationary cost pressures.

We have always said in both businesses, Powder Met and Auto we would drop through at 30%, I would expect that to be maintained on a full year basis. So Powder Met is actually the other way around, they had tougher comparables in H1 prior year, so their drop throughs were not – and plus the operational issues, their drop throughs were dilutive to that 35% Group level. And we are seeing those now coming through, so Q2 was a good testament of that when the drop throughs were actually coming in closer to that 30%.

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Michael Jacks, Bank of America

Super, perhaps just if I could ask one follow up on that. The 30% drop through rate, does that include an element of restructuring derived cost savings? What I'm trying to get to here is whether or not two or three years down the line that drop through rate might fall to 20% once all the restructuring benefits have come through?

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Roberto Fioroni, Chief Financial Officer

Right, so the way I look at it is that 30% is now based on what we have defined as our lean footprint. So it is driven by restructuring, but it's not – we're not seeing incremental restructuring savings flowing through if you see what I mean.

So as we grow in North America and in Europe and as we take advantage of our expansion in Mexico and Hungary, we secure that 30%, but those are sustained – we see those as being sustainable, not being helped by restructuring tailwinds.

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Michael Jacks, Bank of America

Clear, thank you.

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Chris Dyett, Investor Relations

Anymore questions in the room? So turning to questions from the broadcast. I will try not to duplicate questions that have already been asked but do bear with me. So the first question from William at Exane. A question around the exposure to the D3 in terms of revenues?

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Roberto Fioroni, Chief Financial Officer

Hi William, so as I mentioned the annual exposure – our annual sale to the D3s in the North America geography is roughly for the Group 15%. As I said it's very clear to get a number for Automotive, a bit less clear for Powder Met, just because of the tiering level. But 15%.

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Chris Dyett, Investor Relations

Thanks Roberto. The second question also from William is around Powder Metallurgy. The question is around the split between Automotive and Industrial customers in the first half and how you expect this to evolve over time, it is 20% for Industrial, but how do you expect it to evolve?

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Liam Butterworth, Chief Executive Officer

Maybe I can answer, so it's around – say it's 80/20, but it's around 80/20 in the first half, we saw a slight softening actually of the Industrial market in the first half of the year but see longer term it will stay at that kind of level.

We see a significant amount of opportunities in the portfolio for Powder Met that we have been – or the team have been spending a lot of time developing the right product, the right go to market strategy and you know I gave you just some examples of what the team are doing in terms of LFP batteries, magnets, differential gears, so there is a lot of opportunity to proliferate sintering technology in a broader area across the Auto industry. So we see it probably longer term staying around the 80/20 split.

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Chris Dyett, Investor Relations
Thanks Liam.

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Roberto Fioroni, Chief Financial Officer

Maybe just to add a bit more context on that. You know where we see the EV transition really accelerating in the first half order intake is not so much in the shift between Auto and Industrial, but within Auto – you

know the 80%, roughly half of that went into the combustion engine, we're seeing significant order intake for engine agnostic products.

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Chris Dyett, Investor Relations

Thanks. Turning to a question from JP Morgan and José. Two parts to this, what are the key margin drivers for the Auto division to deliver the margin target of 10% plus?

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Roberto Fioroni, Chief Financial Officer

Hello José, again, so the key one there is really volume, as volume dropped through at 30% that's margin accretive and that will drive the expansion. You know if I look at the first half drop through and what I expect for the full year it essentially volume dropping through at a high operational leverage.

Having said that, because volume is an uncertainty just like we said in January we are not standing still. So the expansion in Hungary – sorry the greenfield in Hungary and the expansion in Mexico will give us some one off – some restructuring tailwinds starting next year.

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Chris Dyett, Investor Relations

And the second part of his question, in the short term, so in the second half, how should we think about those two buckets of performance and central costs?

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Roberto Fioroni, Chief Financial Officer

In the second half?

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Chris Dyett, Investor Relations

In the second half.

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Roberto Fioroni, Chief Financial Officer

Of performance and central costs?

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Chris Dyett, Investor Relations

Yeah, central costs and then performance within Auto I suppose, he doesn't clarify.

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Roberto Fioroni, Chief Financial Officer

Okay, so on central costs I mean we're not deviating from previous guidance which is expect those to be on an incremental basis full year about £30m. And on the performance, as I said I would expect the full year volume to be dropping through at 30%. So we saw a higher than 30 in the first half, as I said also driven by the comparables of prior year, we are now going into an environment, if I look at year over year second half of tougher comparables, as I'll just remind everyone, last year we had a skewed customer recovery that came into the second half versus the first half. So I would expect you know just mathematically the second half drop through to be slightly below 30 to get to a full year of 30.

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Chris Dyett, Investor Relations

Sure. The next question is from a shareholder, I'll read it verbatim. Great results, thanks. First could you talk to price levels in side shafts and whether competitors have been able to reduce cots similarly to GKN?

And secondly, could you please elaborate on the restructuring costs incurred this year and for how many years we should continue to expect chunky restructuring costs?

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Liam Butterworth, Chief Executive Officer

I'll take the side shaft price and you can take the restructuring costs?

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Roberto Fioroni, Chief Financial Officer

Okay.

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Liam Butterworth, Chief Executive Officer

Or we could do it vice versa if you want.

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Roberto Fioroni, Chief Financial Officer

I was going to take both, so you're taking one off me.

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Liam Butterworth, Chief Executive Officer

Well I was just going to give some examples of some recent new business pursuits on side shafts where – you know a lot of the sourcing that we see sometimes goes through e-auctions, so we see very transparently what's happening in the market. And you know we have been very successful even recently with a large European OEM where we have booked all of their BEV side shaft business, which was a competitive process and we booked that business, that volume at slightly above our target operating margins for the company.

Why is that? It's because we've got – when you've got such a strong position in the market and such economies of scale that we have got across all of our footprint in terms of manufacturing efficiencies, procurement spend, operational progress. So we can be extremely competitive, and we know that you know where necessary we can book the right programmes, the right business for us. So pricing is relatively disciplined in the space, and we are confident that we can continue to be competitive going forward.

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Roberto Fioroni, Chief Financial Officer

On the restructuring question I'll approach it from a cash perspective, so you know sometimes there is a bit of a delay between P&L and cash. But cash we have said that this year we were expecting to spend about £100m of restructuring and that is still valid, so previous guidance still holds. And then I said that on more of a status quo because in the Automotive industry there is always something to be done. We'd be expecting about 20 to 40 on an annual basis. As of next year the expectation is to start tapering down towards that steady state.

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Chris Dyett, Investor Relations

Thanks Roberto. Possibly our final question, but it is in multiple parts, so I'll go one at a time and it is from our friend Sanjay at Citi. The first question on organic growth, can you confirm that full year, this year's full year, organic growth guidance is to perform at least in line with Auto production and then I'll read the bit around it, which says, this implies 3% outperformance in the second half, can you please provide some colour on key drivers?

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Liam Butterworth, Chief Executive Officer

That's for you.

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Roberto Fioroni, Chief Financial Officer

Hello again, Sanjay, so you know first of all it depends what forecast you take, but if we all agree to use S&P that changes monthly and tends to be a retroactive change. But we are - and UAW strike aside as we agreed this morning, we are expecting to grow revenues in line with production. And I will trust your maths on what it implies for H2.

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Chris Dyett, Investor Relations

Then the second part of the question is around which year do we expect to start performing ahead of the market?

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Liam Butterworth, Chief Executive Officer

We've always said, coming back to what I said earlier on, our strategy is to grow slightly at or above market. But our number one priority is margin expansion. And we are going to stick to that mantal rigorously as we go forward as a business.

Now we are seeing opportunities to grow above market, now is that going to be in '24, '25, I'm not prepared to pin that down. But I think we are confident that we will grow at or slightly above market, but the main priority is margin expansion.

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Chris Dyett, Investor Relations

The next question is around the strikes, we have already had the answer for the first part, so the second part would be around what kind of levers do we have to pull if the strike is elongated?

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Roberto Fioroni, Chief Financial Officer

I mean as Liam said earlier, we have been through a lot of disruption in the last four or five years and fortunately or unfortunately we have learnt how to flex that muscle. I'll just remind people that the Automotive business in 2020 during COVID where volumes were down 20% year over year still ended the year profitably and cash generative. So the levers there I'm not going to go into extensive details, but it's essentially managing costs and managing – sorry working capital, so cost and cash.

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Chris Dyett, Investor Relations

And the final two parts of the question. So on the new eDrive unit order, could you please comment on the magnitude of the order and when it will start to be reflected in sales?

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Liam Butterworth, Chief Executive Officer

So it will start to be reflected in sales, I think it launches early 2026, the back end of 2025. In terms of magnitude of sales it's 1.5 to 2% of Group revenue.

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Chris Dyett, Investor Relations
And then the final question, is there any detail you can provide on magnets?

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Liam Butterworth, Chief Executive Officer

Well as I said first of all on the Capital Markets Day, we said there were three priorities for the Powder Met business, one is margin expansion, the second one is portfolio transition and the third one was to secure technical validation of magnets because we saw that as a great opportunity, a check mark against all three and ahead of plan, especially on magnets.

Now we have a technical validation with a leading Tier 1 automotive supplier in Europe, it's a relatively small contract, but it will be – the fact that the product has now been designed into an electric motor and we will industrialise it in one of our pilot plants in Europe gives us a level of confidence that we have got the right level of supply chain in place and the right technology.

Now we are looking with the Powder Met team right upstream in the supply chain as I say from mine to magnet and working at looking at all the various pieces to make sure we have a supply chain that our customers in Europe and North America are looking for. So we're confident that we can be very successful.

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Chris Dyett, Investor Relations

Thanks Liam, there are no further questions online. Oh, we have one in the room.

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Roberto Fioroni, Chief Financial Officer

One in the room.

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Mark Fielding, RBC

Just could I have a quick follow up on Powder Met actually, and obviously you provided the really helpful slide of the potential content per vehicle from new wins, but do you have some sort of sense of the current content per vehicle, or maybe – I mean specifically I suppose I was wondering what the content per vehicle is for things like you know the engine and transmission bit which is the bit that is being negatively impacted? Just so we get a sense of how these numbers compare to that.

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Liam Butterworth, Chief Executive Officer

Yeah, I wouldn't want to – I couldn't give you a figure off the top of my head because I'd be guessing to be honest. But what we do know is around 40 to 50% of the portfolio today for Powder Met is on engine and transmission. We are seeing significant opportunities outside of that. But I wouldn't be able to give you a number, but we could maybe follow up with a more accurate number.

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Mark Fielding, RBC

Then a really exciting final question, just on the tax rate, obviously you talked about this year, but how are you thinking about the medium term as you get more settled into the business now and what is the potential tax rate a few years out?

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Roberto Fioroni, Chief Financial Officer

So again I'm not going to tie down to a specific tax rate, all I would say is you know the strategy quite openly has changed, right, because with – under the Melrose ownership with just their model of buy, improve, sell – and so holding and asset temporarily and potentially not getting value for a different tax rate depending on what they do this just wasn't a focus in previous years.

I see it as if I benchmark peers we're probably – we're not the highest but we are on the higher end. And so we're just looking at what opportunities we might have there, and we'll update you.

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Liam Butterworth, Chief Executive Officer

Yeah, are we happy with the current tax rate? No, we believe there is work to optimise it. Roberto has established a very strong tax team around him now and one of the things that they are doing post the interims is to work diligently on looking at tax, opportunities to be more efficient with our tax rate going forward.

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Mark Fielding, RBC

Thanks. And then finally actually just central costs as well, are you happy that's now like the right number, are there any impacts this year for example related to the demerger or anything odd?

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Roberto Fioroni, Chief Financial Officer

So the ones you see – no they are not related – adjusted profit there is nothing related, there has been some demerger costs that have gone in as exceptional items. Are we happy with it? I mean the real answer is any cost is too high, but we are keeping it as tight as possible. As I said there's extra cost to be incurred being a standalone Plc that before were incurred by Melrose. The incremental is about £30m, that is what we have committed to, and we are keeping to that number.

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Mark Fielding, RBC

Thank you.

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Liam Butterworth, Chief Executive Officer

Okay. So maybe just to conclude you know as the CEO of the business and on behalf of me and the entire team I don't think we could be happier in terms of our first set of interim results and what we've delivered.

We have exceeded expectations across the three areas that we said we were going to perform on and I'm looking forward to bringing another great set of results to you when we speak again at the end of the year. So thanks for your time and your questions.

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END