

QA session transcript from Kitron ASA CMD 2017-02-16

Peter Nilsson: Let's open it up for some questions and answers. Go ahead, first question from Sweden.

Guest 1: *Thank you. Can you talk a little bit about what could cause major deviation to the major upside or downside to the 2020 targets. What would have to happen for it to be significantly either below or above that? Could you talk about some of the sensitivities there? And then, second question on leverage. How high would you be able to go up, if you found a suitable acquisition?*

Peter Nilsson: Good question. Well, we do a sensitivity analysis for each year. We did the 2020 sensitivity analysis in the summer of 2015, when we set the target. The upside on that analysis was very high. We looked at risks and timeline and finally ended up at the 3 billion ambition. Let's look at four big blocks of the 3 billion. Assume that we're at about 2.2 today. We have 200 coming from the US defence aviation programs. We have another 200 a year coming from the Swedish defence industry. We've got probably another 100 a year coming out of the German defence industry. That's 500 right there. I spoke earlier about 300 million from the German market including 100 of German defence. So that's in the vicinity of 700 or so. What can happen in those building blocks? Well, there can be timing issues. Is the technology in the product ready for the market or not? Will there be challenges during product verification? Those are things that can happen on the downside. On the upside, well, there was an announcement yesterday. NATO met this week, and the upside is that, with defence spending in Europe, you have to hit or exceed your 2 percent level or you're out, basically. We expect defence spending to increase. We're well positioned to take advantage of that increase with close co-operation with all major suppliers including the ThyssenKrupp and Rheinmetall group.

Regarding leverage: The gearing is 1.3 right now. We feel comfortable to go up to about 3.5 in the short term. And still be comfortable. And let's try to stay below 2.5 in the longer term.

Guest: *Can you perhaps walk us through how Kitron, as it is set up now, would handle the next eventual down-turn? Sort of the next global recession. How will that, as Kitron is today, affect revenues, margins, how flexible is the staffing?*

Peter Nilsson: Our major operating expense is labour cost. We closely monitor our demand outlook. We've put systems, procedures and processes in place to give us early warning on demand variances. Our overall ambition is to have 30 per cent flexibility in our workforce to cope with short term downturn in demand. When the downturn in demand is has a longer recovery period, for example the Oil and Gas sector, we look at more lasting structural changes.

Guest: *Could you also talk a bit about the top line? Obviously, defence is more of a defensive kind, but the other elements, where you are part of a supply chain, where you will sort of move slower. During a recession, how much could we expect to see? How much downside could we see in the top line?*

Peter Nilsson: It's difficult to say how markets would react. I can't speculate in every market sector, what will happen. A lot of our products is infrastructure investing. It goes into railways, roadworks, and Water management systems, modernization of power infrastructure, Hospital and emergency care upgrades, upgrades of security systems for identification and storage of biometrics. These investments are not strongly correlated to fluctuations in the consumer market. The cycle tends to move slower. Our exposure to many different customers and end markets also help to smooth demand fluctuations, as the current downturn in Oils and Gas has shown. We prepare ourselves by continuously refreshing our outlook and having a solid forecast and discussion with our

board on a quarterly basis. This ensures what activities we're doing, to either continue our growth or protect our margins if we see a downside.

Guest: *Thanks. One question on the defence side: One thing is the direct deliveries to the F-35. As part of the program, there are repurchase agreements between governments where there are other opportunities in the defence base. How significant could that be for you?*

Peter Nilsson: I think you're dying to answer that question, aren't you? Hans Petter, do you want to take it?

Hans Petter Thomassen: Yes, I can take it. I would say that the best way to answer it, is that we are...First of all, the F-35 program is what they call a best-value program. So you are part of a closed competition among the partner nations. On other defence-related business, we are monitoring very carefully all the activities in infrastructure renewals in Europe. And we represent an opportunity to support Norwegian technology being exported to those countries, and we also represent an opportunity to have local content for the OEMs who are bringing defence materials into Norway. So we're sort of working both ends of the deal.

Guest: *How significant?*

Peter Nilsson: I don't think I should speculate on the numbers there.

There are many investments going on that have not been decided on yet. And we don't know who the partners are going to be. For this system, is it Lockheed or is it Saab or is it Rheinmetall. But all of these companies are our customers and we are working with all of them, so of course we discuss with all of them.

Hans Petter Thomassen: And we work long-term, we work very strategically. We have been positioning towards, let's say the submarine acquisition that has been coming for a long time already. And that positioning is looking like it's going to be paying off.

Peter Nilsson: But we don't know what the values are or when in time that will be.

Guest: *You were talking about looking at 3 different M&A axis. Can you indicate which of these axes you are looking at the closest right now?*

Peter Nilsson: We don't have any activity going on right. We continuously see opportunities, both in new geographies and in existing geographies. We want to feel comfortable with what whatever type of acquisition we do. We feel comfortable with aerospace, we feel comfortable with defence and medical, industry products, infrastructure products. We focus on areas where Kitron can contribute value to the acquisition.

Guest: *You have a very strong balance sheet and low gearing. I mean with capex aligned with depreciation. You're basically going to de-lever further with the current dividend policy. Could you give a scenario where you consider paying out more than 60 percent or extraordinary dividends?*

Peter Nilsson: We have a good policy right now. I'm happy with that policy. And I'm happy with where we're heading with the company and how we want to grow the company and what we want to do to get there.

Guest: *In terms of marine and offshore, have you put in any assumptions with regards to revenue there with regards to your guidance for 2017. And can you say something what you have included in your assumption for 2020 ambition?*

Peter Nilsson: We don't have any growth in oil and gas in our assumptions. But I think we based it on where we were

in 2015 and kept it at that level. We're not closing the door to growth in that sector, we're open to opportunities, and it's well within the scope of our capabilities, but I think that's wishful thinking to start talking about 2020 and having some major part of revenue where you haven't identified opportunities today.

Guest: *Thanks for a clarifying capital markets day. On page 51, you outline your targets regarding OPEX to sales, ambitions to decrease from 27.6 in 2016 to 25.0 in 2020, important driver for margin. At the same time, you have an ambition to increase the EBIT margin by 1.4 percentage points in this period, roughly half of the magnitude of the OPEX and sales reduction. That implies that your gross margin is going to decrease. Obviously for your business, the gross margin is very much important for your EBIT margin. Can you elaborate a little bit on why you think your gross margin is going to decrease, despite your efforts to improve efficiency?*

Peter Nilsson: Our assumption is that that gross margins are more pressured in the industrial sector and we will grow a lot within this sector. So you're correct in your assumption, overall.

It's been a great day for us. Kitron is a great company to work for. I have a wonderful team to support me with Israel and Cathrin and the four guys sitting in the front here. And all the guys and gals who work for them. It's a pleasure to work with these guys and all our customers. I really enjoy that. So, we hope to be able to continue delivering on our projections for this year and we'll see you all in the quarterly webcast for first quarter. Very good. Thank you so much.