Autoliv Q3 2023 Results

Friday, 20th October 2023

Introduction

Anders Trapp

VP, Investor Relations, Autoliv

Welcome

Welcome everyone to our Third Quarter 2023 Earnings Call. On this call, we have our President and CEO, Mikael Bratt; and our Chief Financial Officer, Fredrik Westin; and me, Anders Trapp, VP, Investor Relations.

Agenda

During today's earnings call, Mikael and Fredrik will, among other things, provide an overview of the strong sales, earnings, and cash flow development we had in the third quarter, the structural cost reduction activities that we are doing to secure our long and medium-term competitiveness and our updated full year indications, as well as provide an update on our general business and market conditions. We will then remain available to respond to your questions. And as usual, the slides are available on autoliv.com.

Disclaimer

Turning to the next slide. We have the safe harbour statement, which is an integrated part of this presentation and includes the Q&A that follows. During the presentation, we will reference some non-US GAAP measures. The reconciliations of historical US GAAP to non-US GAAP measures are disclosed in our quarterly press release that is available on autoliv.com and in the 10-Q that will be filed with the SEC.

And lastly, I should mention that this call is intended to conclude at 15.00 Central European Time. So please follow a limit of two questions per person.

I will now hand over to our CEO, Mikael Bratt.

Opening Remarks

Mikael Bratt

CEO, Autoliv

Q3 ’23 Key highlights

Continued strong performance

Thank you, Anders. Looking on the next slide. Our performance continued to improve substantially in the third quarter. First, I would like to thank our employees for their great contributions to the third quarter results and the efforts to further strengthen our near and medium-term competitiveness.

Our organic sales grew double digits, outperforming light vehicle production significantly, especially in Asia. The strong growth was mainly a result of higher-than-expected light vehicle production, product launches and customer compensations for inflationary pressure.

The adjusted operating income was a new record for a third quarter since the Veoneer spin-off. We generated a broad-based improvement in key areas, including gross and operating

margins both year-over-year and sequentially. Our cash flow was strong, and the debt leverage remained well within our target range, while we maintained our dividend and almost tripled the number of shares repurchased compared to the second quarter.

We are making progress towards our intention of reducing our indirect workforce by up to 2,000. We have now detailed a large part of our structural cost reduction actions, including optimisation of the company's geographic footprint and organisation.

The National Highway Transportation Safety Administration has issued a new initial decision to recall 52 million airbag inflators benefited by our competitor, ARC. Autoliv estimates that less than 10% of the identified inflators were included in airbag modules that Autoliv supplied to customers after Autoliv acquired certain Delphi assets in 2009.

Autoliv is not aware of any performance issues regarding the ARC inflators included with its airbags. At this stage, it is too early to talk about any replacement plan. We are, of course, prepared to support our customers with replacement products.

The light vehicle production in 2023 is now expected to develop slightly better-than-expected, and we have therefore increased our full-year organic sales indications in line with this. We expect fourth quarter adjusted operating margin to improve by 1.5 to 2 percentage points compared to last year, in line with the previously communicated improvement pattern.

Additionally, we expect the ongoing reorganisation of our global functions and European operations to lead to lower tax rate for 2023 than previously anticipated. These changes are also expected to reduce our normalised tax rate from 2024 and onwards to a range of 25% to 30%.

Now looking at the significant sequential cost improvements on the next slide.

Significant Sequential Cost Improvements since Q1 ’23

Towards our updated Full-year indications

Year-to-date, we have generated a broad-based improvement in key areas, both year-over-year and sequentially. On this slide, we highlight the sequential improvements. In the third quarter, we continued to actively address our cost base while negotiating with our customers to secure pricing and other compensations that reflect the high inflation.

Our labour efficiency continues to trend up, supported by the implementation of our strategic initiatives, including automation and digitalisation. Our gross margin improved by 270 basis points compared to the first quarter and by 90 basis points from the second quarter. This is mainly a result of the higher labour efficiency and customer compensations.

The positive trend for RD&E and SG&A in relation to sales, have continued and has now declined by 130 basis points since Q1. Combined with the gross margin improvements, this led to a substantial improvement in adjusted operating margin.

Q3 ’23 Financial Overview

Strong sales and profit development

Looking now on financials in more detail on the next slide. Sales increased by 13%, mainly due to new products, higher prices and favourable currency translation effects. The strong sales increase and cost reduction activities led to a substantial improvement in adjusted operating income.

Excluding effects of capacity alignment and antitrust-related matters, adjusted operating income increased by more than 40% to $243 million from $173 million last year. The adjusted operating margin was 9.4% in the quarter, an increase by close to 2 percentage points from the same period last year and by over 4 percentage points from the first quarter.

Operating cash flow was $202 million, which was $30 million lower than the same period last year. The main reason for the lower cash flow was the unusual strong cash flow last year, which was related to timing effects of customer recoveries.

Looking now on the limited impact of the UAW strike in North America on the next slide.

Limited Impact of the UAW strike

The UAW strike in North America is in its fifth week. The impact on Autoliv in Q3 was very limited. Our North American employees are not represented by UAW, but we are indirectly impacted by lost sales and a more unpredictable and volatile LVP.

In the first half 2023, the Detroit-3 North America accounted for around 13% of our global sales, or 36% of our sales in Americas. We estimate that we lost less than $2 million in sales in third quarter. As per 19th October, the per week revenue hit from the assembly plant strike is around $6 million. We have developed a response plan to the strike and built some inventory of components and finished products to support a quick ramp-up when the strike is over.

At this point, it is difficult to estimate the full impact of the UAW strike on our fourth quarter sales and profitability. There are many unknown factors, including scope, length of action as well as potential recovery of lost volumes after the strike, but also possible sales increases for brands not affected by the strike actions. Our full year 2023 indications are based on the assumption that the UAW strike is not prolonged beyond what is included in the S&P Global October outlook.

Looking now on the announced structural cost reductions initiatives on the next slide.

Accelerated Structural Cost Reductions

Simplifying our logistics and geographic footprint to significantly lower our cost base

To secure our medium-and long-term competitiveness and to support our financial targets, we are accelerating our global structural cost reductions, as previously communicated. This includes a substantial reduction of our global workforce with a particular focus on our European operations. These initiatives will continue to optimise our geographic footprint for a more effective structure while reducing costs and driving improvement in margins and cash flow.

We intend to simplify and consolidate how we operate in all areas. The headcount reduction will affect people in our offices, technical centres and plants, including leadership positions at all levels. On 13th July, we announced the first step of our planned reductions of around 1,100 indirect and direct employees.

On 5th October, we announced the reduction of 300 indirect employees in China, Japan, Sweden, and the United states and the closure of an office in Netherlands. These first steps are expected to reduce cost by around $35 million in 2024, $65 million in 2025 and $85 million when fully implemented.

Looking now on our sales growth in more detail on the next slide.

Q3'23 Sales Growth and Regional Sales Split

Our consolidated net sales increased to $2.6 billion, a record for a third quarter. This was close to $300 million or 13% higher than a year earlier, driven by price, volume, mix and currencies.

Out of the period cost compensations contributed with $6 million. Out of period compensations are retroactive price adjustments and other compensations that mainly relate to first and second quarters but were negotiated in the third quarter.

Looking on the regional sales split: Asia accounted for 40%, Americas for 35% and Europe for 25%. We outline our organic sales growth compared to light vehicle production on the next slide.

Q3'23 Organic Sales Growth – Outperforming Global LVP by 7pp

I am very pleased that our organic sales growth significantly outperformed global light vehicle production growth in the third quarter, as we continued to execute on our strong order book.

According to S&P Global, third quarter light vehicle production increased by close to 4% year-over-year. This was 7 percentage points higher than expected at the beginning of the quarter, with most of the higher-than-expected production coming from domestic OEMs in China and OEMs in Eastern Europe.

In the quarter, we outperformed global light vehicle production by around 7 percentage points. We outperformed in the rest of Asia by 15 percentage points, in Japan by 14 percentage points and in China by 6 percentage points. The performance in China was mainly driven by increasing sales to the fast-growing domestic Chinese OEMs.

Our sales to this Group outperformed light vehicle production with close to 30 percentage points as we continue to deliver on the strong order book in China. We expect a positive year-over-year sales growth trend to continue into the fourth quarter.

Q3'23 Key Model Launches

On the next slide, we see some key model launches from the third quarter. In the quarter, we had a high number of product launches, especially in China and Europe. The trend towards electrification is clear with six models on this slide being available as electric version. Six of the models shown on this slide have an Autoliv content per vehicle of around $300 or higher, with the highest at over $750.

In terms of Autoliv sales potential, the BMW i5/5 Series launch is the most significant. For the full year, we expect a record number of launches with high number in China, Europe and South Korea.

I will now hand it over to our CFO, Fredrik Westin, who will talk about the financials on the next few slides.

Financial Review

Fredrik Westin

CFO, Autoliv

Q3'23 Financial Overview

Thank you, Mikael. This slide highlights our key figures for the third quarter of 2023 compared to the third quarter of 2022.

Our net sales were $2.6 billion. This was a 13% increase. The gross profit increased by $82 million or by 21% to $465 million, while the gross margin increased by 1.3 percentage points to 17.9%. The gross profit increase was primarily driven by price increases, volume growth, lower costs for material and premium freight. This was partly offset by increased costs for personnel, related to volume growth and wage inflation.

In the quarter, we made a total adjustment of $11 million to the operating income, of which $10 million was for capacity alignments. The adjusted operating income increased from $173 million to $243 million, and the adjusted operating margin increased by 180 basis points to 9.4%. I will explain more when we go through the operating income bridge.

Adjusted earnings per share diluted increased by 43 cents, where the main drivers were 57 cents from higher adjusted operating income, partly offset by 10 cents from financial items and 7 cents from taxes. Our adjusted return on capital employed and return on equity increased to 25% and 21%, respectively.

We paid a dividend of $0.66 per share in the quarter, and we repurchased and retired around 1.23 million shares for $120 million under our stock repurchase programme.

Looking now on the adjusted operating income bridge on the next slide.

Adjusted Operating Income Bridge

vs. prior year

In the third quarter of 2023, our adjusted operating income of $243 million was $70 million higher than the same quarter last year. Our operations were positively impacted by improved pricing and other customer compensations, higher volumes, lower cost for premium freight as well as by our strategic initiatives that were partly offset by the significant headwinds from general cost inflation.

The impact from raw material prices was limited. Out-of-period cost compensation was approximately $6 million lower than during the same period last year. FX impacted the operating profit negatively by $8 million. This was mainly a result of negative translation effects. Costs for SG&A and RD&E net combined was $14 million higher, mainly due to higher personnel costs and projects. However, in relation to sales, it was down 50 basis points.

As a result, the leverage on the higher sales, excluding currency effects, was in the upper half of our typical 20% to 30% operational leverage range. This is despite not getting any leverage on the inflation compensation from our customers.

Looking now on the cash flow on the next slide.

Cash Flow

Temporary negative working capital effects

For the third quarter of 2023, our cash flow decreased by $30 million to $202 million compared to the same period last year, mainly as a result of less favourable working capital effects, partly offset by the higher net income. Year-to-date, operating cash flow increased by $285 million compared to the same period last year to $535 million, mainly due to higher adjusted operating income and less negative working capital effects.

During the third quarter, working capital grew by $36 million, driven by higher inventories. We will provide more information on trade working capital on a later slide. Capital expenditures net decreased to $151 million from $164 million in the previous year. Capital expenditures net in relation to sales was 5.8% compared to 7.1% a year earlier.

Free cash flow was $50 million in Q3, $18 million lower than a year earlier. And year-to-date, free cash flow has improved by $186 million to $117 million. Our full year indication of an operating cash flow of around $900 million is unchanged. Last 12 months cash conversion, defined as free cash flow in relation to the net income was 99%.

Now looking on our trade working capital development on the next slide.

Trade Working Capital in Relation to Sales

During the third quarter, trade working capital increased by $11 million, driven by $35 million higher inventories, partly offset by $14 million higher accounts payables and by $10 million in lower receivables. The higher inventories was mainly due to the continued volatility and the UAW strikes.

In 2019, we launched our Capital Efficiency Programme aiming to improve working capital by $800 million. To-date, we have achieved almost $350 million, all from payables so far. Receivables and especially inventories are lagging due to the high call of volatility and hence planning challenges resulting in inefficiencies. We do expect this to improve significantly in tandem with reduced call off volatility.

Now looking on our leverage ratio development on the next slide.

Debt Leverage Ratio

Our debt leverage ratio at the end of September 2023 was 1.3 times, unchanged compared to the prior quarter. This was a result of $76 million higher net debt and $77 million higher 12 months trailing adjusted EBITDA.

Now looking on shareholder returns on the next slide.

Strong Balance Sheet & Cash flow Supporting Shareholder Returns

Autoliv has shown in the past several years, its ability to generate solid cash flow in periods with difficult market environments, such as COVID lockdowns, the war in Ukraine, industry supply chain challenges and related substantial decline in light vehicle production.

We have used both dividend payments and share repurchases to create shareholder value. Historically, the dividend has usually represented a yield of approximately 2% to 3% in relation to the average share price. Over the last five years, we have reduced the net debt significantly while returning $1.2 billion directly to shareholders. This includes stock

repurchases of 3.6 million shares for a total of $317 million as part of our current stock repurchase programme.

We are considering several factors when executing the programme such as our balance sheet, the cash flow outlook, our credit rating and the general business conditions, not only the debt leverage ratio. We always strive for the balance that is best for our shareholders, both long and short term.

I will now hand it back to Mikael.

Operational Review

Mikael Bratt

CEO, Autoliv

Light Vehicle Production Outlook

Autoliv expects global LVP to increase by ~7% in 2023

Thank you, Fredrik. Looking at the next slide. As supply chains have improved in many regions, vehicle demand, sales backlogs and inventory restocking are now the main drivers of market development.

S&P Global now expects the fourth quarter global light vehicle production to increase by 3.6% compared to last year. Compared to the third quarter, volumes are expected to increase by around 2% due mainly to normal seasonality from summer shutdowns in the third quarter.

Despite concerns surrounding elevated vehicle pricing in some markets and deteriorating credit conditions, global full year 2023 light vehicle production is projected to increase by over 7%. This is 250 basis points higher than their forecast from July. This increase is driven by lower content vehicle models in China and higher growth in Eastern Europe, while production forecast for higher content markets, such as Western Europe and North America, is lowered.

For Autoliv, this change impacts average content per vehicle negatively by more than 100 basis points compared to S&P's July forecast.

Light vehicle production in China continues to show relative strength, owing to both a strong EV demand and export activity, mainly benefiting the domestic OEMs. Near-term light vehicle production in North America continues to be impacted by the ongoing UAW strike.

The latest S&P forecast for the fourth quarter is revised down to minus 7%. This includes the continuation of the strike actions already announced through Thanksgiving. Production in Europe is, to a large extent, secured by OEM sales backlogs. However, we are starting to see that underlying demand has abated due to higher vehicle prices and tighter credit conditions and the order backlogs at OEMs are shrinking going into 2024.

We based our full year sales indication on global light vehicle production growth of around 7%.

Now looking at adjusted operating margin progression in the next slide.

Adjusted Operating Margin Progression

For the fourth quarter, we expect substantial improvements of the adjusted operating margin. We anticipate further cost compensations from customers. The headcount reductions that we talked about previously should support operating leverage and profitability. We expect continued high year-over-year sales growth, supported by launches, higher light vehicle production and higher prices.

We have continued to see an improvement of supply chain stability throughout the year with reduced customer call-off volatility. However, the improvement is somewhat slower than we had expected as it deteriorated somewhat in Europe in Q3. This, together with the higher sales and adverse FX development means that we expect a fourth quarter adjusted operating margin improvement year-over-year of around 1.5 percentage points to 2 percentage points, in line with the previously communicated improvement pattern of around 2 percentage points each quarter throughout 2023.

Looking at our full year 2023 financial indications on the next slide.

Updated Full Year 2023 Indications

This slide shows our updated full year 2023 indications. The indications exclude costs and gains from capacity alignment, antitrust-related matter, a litigation settlement, and other discrete items.

Our full year indication is based on the light vehicle production growth assumption of around 7%, up from 4% in the previous indication. As a consequence, our organic sales are expected to increase organically by around 17% instead of the earlier indications of growth of around 15%.

Currency translation effects are assumed to be around positive 1%. The range for the adjusted operating margin is unchanged around 8.5% to 9%. Operating cash flow is expected to be around $900 million. Our positive cash flow trend should allow for continued high shareholder return.

Note that our full year 2023 indications are based on the assumptions that the UAW strike is not prolonged beyond what is included in the S&P Global October outlook.

I will now hand it over to Fredrik to briefly talk about 2024 and the improvements we see.

Looking into 2024

Fredrik Westin

CFO, Autoliv

FY'24 – key factors expected to impact operating margin

Turning to the next slide. For 2024, we see some tailwinds and headwinds. The main tailwinds include call-off stability, leading to direct labour efficiency improvements, savings from the structural initiatives, as outlined earlier, effects of continued operational improvements from automation and digitalisation, but also favourable raw materials and executing on the strong order book.

The main headwinds include operational headwinds from expected continued inflationary pressure, although smaller than this year, which we expect to lead to a customer compensation catch-up later in the year, just as it was in 2022 and 2023.

Considering these potential tailwinds and headwinds, we expect a year-over-year improvement in adjusted operating margin. We expect 2024 to be an important step towards our medium-term target of 12% adjusted operating margin.

As we have communicated, the medium-term targets rests on a few key conditions, which are that global light vehicle production is at least 85 million, that the call-off volatility is back to pre-pandemic levels and that we have full compensation for inflationary pressure after 2021 for a full year.

We intend, as usual, to come back with the 2024 full year indication in connection with our fourth quarter earnings release in January.

And I will now hand it back to you, Mikael.

Mikael Bratt: Thank you, Fredrik. On to the next slide. This concludes our formal comments for today's earnings call, and we would like to open the line for questions from analysts and investors.

Q&A

Emmanuel Rosner (Deutsche Bank): I had two questions around some of the factors you have highlighted going into 2024. The first one you are mentioning on this slide is the customer call-offs as a positive. So just was curious if you could give a little bit more colour of what you have seen in Europe this quarter where you indicated that there may have been some sequential deterioration. What do you think drives this? And is that an ongoing issue?

And then as we move essentially into 2024, how do we think about these savings? Is it just better incremental margin on higher volume? Or is there a discrete bucket of headcount reduction that you can achieve as a result of more stable call-offs?

Mikael Bratt: Thank you, Emmanuel. Let me start with the call-offs and then hand over to Fredrik to take you through the second part of your question.

As we have talked about throughout, not only this year, but since some time back, we have had a challenging situation when it comes to volatility resulting in stop and go in our operations. And that has, throughout the year, improved and going in the right direction, including Europe.

But what we saw in Q3 in Europe was that it turned for the worse again. And that is, purely related to supply issues in our customers' value chain. The root causes for that could vary. For example, we still see that the semiconductor situation is a problem for some of our customers. We have no reason to believe that this deterioration in Europe comes from any end consumer deterioration or situation at all.

So I see it's very much connected to the reasons we have had in the last quarters and years that, unfortunately, went in the wrong direction for Europe. But otherwise, I would say, as an average, we are climbing up towards the 90% level. But as you remember, pre-pandemic,

we were basically at 100%. So we are still far from where we were before the pandemic when it comes to the stability altogether in the company regardless of region there.

Fredrik Westin: For next year, if you look at S&P Global, based on that, the expectation is that we should also expect some although a bit limited, volume growth. So that should help the margin development. But then it is more importantly to see further improvement on the call-off stability.

We do have significant inefficiencies in our operations due to the current significantly lower level of stability. And the further this comes up to the 100% that Mikael mentioned, the more it will allow us to operate at the efficiency levels that we have been used to. But of course, then the third component is the structural initiatives that we have added on to this and both on the indirect side and the direct side that is also supported by what we are doing in automation and digitalisation.

Emmanuel Rosner: And then my second question is specifically about the structural initiatives. I think earlier in the year, when you had first announced a plan for headcount reduction, I think you had mentioned at the time a potential total of 8,000 headcount reduction. I think so far, based on the plans announced, the first steps, I think you announced maybe about 1,400 or so of this 8,000. So obviously, a lot more to go. So my questions are, is 8,000 still the right number in the current environment? And then what would be the timing for not just announcements of additional steps, but can any of those still benefit 2024? Or would that be beyond that?

Fredrik Westin: We did announce 8,000, but we also split that into two groups. It was 2,000 of what we call indirect or salaried employees and then 6,000 on the direct side. The direct side, the 6,000 is very much connected to what we just talked about before.

It is also based on that the stability levels on the call-off also support that. And then we should be able to come back to the regular type of productivity achievements that we have been operating at, which will then allow us to take out 6,000 people with the volumes of end of March as the basis for that number, and that is progressing.

Then on the 2,000, we have announced so far 1,400 of which 300 were direct, which means out of 2,000, we have announced 1,100. And also, the savings associated with that. There is more to come, but we have so far progressed on more than half of the 2.000. And cost-wise of what we have taken also more than half has been booked already. And you can also see now in the third quarter that our headcount is down by 400 employees on the indirect side. So yes, some of those activities are already in place.

Colin Langan (Wells Fargo): In the last slide, you noted inflationary pressure and the timing of customer compensation as the big headwind into next year. I mean, what are the new inflationary costs that we should be thinking about into next year? Or is it that you are getting a little bit more pushback on getting recoveries? Is that the other part of the issue? And then in general, can you just remind us how much of what you have already gotten recovered is in the piece price versus what would actually need to get maybe renegotiated at the start of next year?

Fredrik Westin: We use the same macroeconomic forecast that you have at your hand and available. We do expect that inflation level should come down vs as they are right now, and they should be lower next year than this year. But we do also expect that especially labour will have a higher inflation level next year than what it has had at historical averages, but most likely less than what we have had in this year. But we will come back to that when we talk more specifically on 2024.

Then on the recovery side, I think we have progressed as expected. We did indicate after the second quarter's earnings or in the call that there might be a delay from Q3 into Q4, but that has not really happened. So Q3 developed as we had expected initially, meaning that it is not as much back-end loaded in this year as we had communicated back then.

And it was more piece price recovery in the third quarter here now with the lump sum than what we have communicated in the second quarter.

Colin Langan: But does that mean when you go into next year, you will have to renegotiate those lump sum again? And is that a concern as you go into next year that you might get more pushbacks given the labour inflation the automakers are facing?

Mikael Bratt: No, I think already last year, we also had lump sums that we negotiated this year. I think the important thing is that we have a process together with our customers how to get compensated for the inflationary components. And we have, an annual process here where we take that into account.

I think the split of what is lump sum and what is more piece price related is connected to the type of inflation. You could say, if it is something of temporary nature, it should not need to be in the same level as we move forward. So it is a very detailed negotiation with each customer.

But what you need to remember also is that this is mirroring what we have with our suppliers. So we have a fair amount of lump sums paid to our supplier base as well. We balance these two sides of the business here against each other here to make sure that we have a good cost structure and a flexible cost structure to offset any changes there.

But for me, I feel very comfortable with the way we get compensated. And as long as we are in the inflationary environment, this will be ordinary course of business to negotiate with our customers on an early basis for this type of costs.

Mattias Holmberg (DNB Markets): First, I would just like to clarify on the tax rate given that it is likely to have quite a material impact on the net profit going forward. So in order to get to the 20% for the full year, given that you have had a bit above 30% year-to-date, am I correct to assume that you are paying basically zero tax in Q4? And then also on that topic, the 25-30% that you see a new normalised tax rate going forward, quite a wide range and also significantly lower than the 32% you have had in the past. Could you specify it perhaps a little bit more than that? Or is there any reason why you have given such a wide range?

Fredrik Westin: Yes, you are right. We were taking down the guidance here for the taxes of 32% to around 20%. This is due to the ongoing very significant reorganisation of both global functions and our European operations, which is expected to lead to a reduced tax rate in this year, which is also very much associated with the ongoing restructurings. But this is not cash effective in this year. So it will not affect the taxes paid in this year.

Then going forward, we do expect the normalised tax rate to be then around 25-30% from 2024 onwards. I think using the midpoint of that range is not a bad assumption at the moment. And this will then be impacting the taxes paid also from 2024 onwards.

Mattias Holmberg: And should we view this as a permanent steady state going forward in terms of tax rate?

Fredrik Westin: Yes, you can.

Mattias Holmberg: And then final question for me. You mentioned the potential recall here of the ARC inflators. I am just curious, are you as a company liable for the inflators ARC has produced? Or how would that work in a potential recall situation?

Mikael Bratt: ARC is a competitor to us. That is their exposure. Then of course, our part of that, as I mentioned here, is where we have purchased these components from them. So we are also a customer to them in this regard.

And the portion that is related to Autoliv modules as far as we understand and see here, there has not been any cases connected to that volume here. So we are following this development very closely, but we see this also clearly as something we can support our customers with in case of a recall, but where they need to have replacement, but we are not there yet.

Mattias Holmberg: And do you believe that you could get compensation in a potential recall from ARC, or would you have to cover that cost yourself?

Mikael Bratt: If there would be such a situation, our expectations is that this is on ARC's accounts, for sure.

Jairam Nathan (Daiwa): I was just wanted to go to the outperformance slide. So it looks like the outperformance in North America and Europe have declined quite a bit from the first half. And what are the main reasons for that? And how should we think about the regional outperformance for next year?

Mikael Bratt: No. I think if you go back in time, you can see that this number is a little bit volatile, but that direction is clearly that we are continuing to grow our market share in our respective regions you talked about here. And in a single quarter, you can have certain mix effects. So I should not read in too much to that. I think we are steadily moving towards the market share of around 45% that we have communicated earlier on.

And yes, I think we have a good activity level also to backfill our order book here to support that.

Jairam Nathan: Okay. And just finally, on the share buybacks and to debt levels. But given the higher interest rate environment and maybe for longer, does that change your thinking on the debt levels and buyback funding?

Mikael Bratt: I think we believe that with the good cash flow generating operations we have today, it supports well the buyback programme that we are committed to here, and I do not see this being something that would affect our way forward here.

Giulio Pescatore (BNP Exane): The first one on the guidance, just quickly. Just trying to understand exactly what assumptions are you incorporating with regards to the strike. So, you said you are in line with IHS. Does that mean that you expect the strike to continue until the end of November? I think that is what S&P is currently forecasting. And does that mean

$6 million per week until the end of November? Is that what you are including in the 1.5% to 2% margin improvement in Q4?

And maybe if you can give us also an indication of what operating leverage or drop-through on that lost revenue are you incorporating in the assumption?

Fredrik Westin: The short answer to your first question is yes. So it is until the end of November. And from what we can tell right now, it is around $6 million per week that is the impact on our top line. Of course, this can change daily.

And on the drop through here, it remains to be seen what that will be at the end of the quarter. As Mike mentioned here before, we do see that at the moment, the volumes seem to be picked up also by some of the competitors. They are not unionised by UAW. So it is still a very fluid environment here that we need to monitor throughout the quarter.

Giulio Pescatore: Okay. And you are also not assuming a big pickup after the end of the strikes, a big pickup in volumes?

Mikael Bratt: Yes, I think some pickup if it goes through into basically Thanksgiving and then a pickup then to recover some of that volume in the fourth quarter. But again, it is very fluid and it remains to be seen here how the overall volumes also develop.

Giulio Pescatore: Okay. Then the second question on the ARC recall. Is it fair to say that you stand to benefit way more than you start to lose out of this recall? Both in terms of the potential replacement impact and in terms of the long-term implication with regard to pricing if one of your competitors was to suffer. And that is the first part of the question.

And the second part is, can you maybe help us quantify the potential opportunity for you on the replacement side? Because it feels like it is very significant, right? It is over the course of 10 years, of course, but let us say, that the $52 million recall does materialise. I mean, is it fair to say that you might have 50% share of that recall? And can you just help us understand the opportunity here if recall does go into effect?

Mikael Bratt: I think it is too premature to speculate in that. I mean, as we all know, it is not in that stage yet, and there is work with NHTSA and, of course, ARC and the customers that is ongoing. So we are standing by and willing to support our customers, if needed. But it is too early to start to talk about any numbers or potentials in this. We just have to wait and see.

Agnieszka Vilela (Nordea): So starting with the EBIT bridge, I note that probably for the first time in nine quarters, you reported positive impacts from raw materials, a moderate one, but still positive. So could you please maybe talk about some deflation that you see in your cost input? And what it is related to? That is my first question.

Fredrik Westin: Yes. Correct. It is the first time in a long time here that we see a positive effect on raw materials. We have guided for a flat development for the full year, which means that we should see an even stronger positive development also in the fourth quarter. So yes, we do see that raw material price costs are coming down for us. So far, it has been mainly driven by non-ferrous metals, especially magnesium, that has come down from the peaks, but also steel has been favourable, but we have seen still some increases this year, especially on the textile side. But we also expect that this should be more favourable going forward.

Then on what this means for next year, I mean, as we said before, we have this six to nine months' time lag between, where, say, spot prices or indices are moving until that manifests itself in our cost structure. So we are monitoring very closely what that means, but we will talk more specifically about that with the guidance for next year.

Agnieszka Vilela: Great. And just to understand a follow-up on that. Will your customers require then price decreases because of lower input cost for you? Or how should we think about it?

Fredrik Westin: Yes. We do expect that we will then also give some of those price decreases back to our customers. And then we have a higher level of pass-through clauses with the customers now. So yes, when raw material costs comes down, we then also adjust our prices accordingly. But I mean, that should have a favourable impact on the margin because it was margin dilutive on the way up, and then it should be somewhat accretive on the way down.

Agnieszka Vilela: Perfect. And then my second question, I think, Mikael, you mentioned that the car production in Europe so far is secured by backlog, but you see demand abating and also order backlog shrinking going into 2024. And if colour you could provide to us when you speak to your customers in Europe in regards to their production planning?

Mikael Bratt: Yes, as you know, the problem we have here is that even if we have visibility, the pickups is deteriorating. So it is in a short-term perspective where we have the challenges within the week. Otherwise, I think when it comes to the overall production planning, there is nothing indicating that we are looking at the weaker European market.

I think what is happening is that after all these years of backlog build-up, that is now normalising. So I would say, from a consumer point of view, we have nothing indicating that we should have lower volume due to that. I think we are seeing more normalisation of backlog and volatility coming from the supply component issues that we have talked about earlier. So otherwise, we do not see anything.

Hampus Engellau (Handelsbanken): Two questions from me. First, Mikael, if you could maybe talk a little bit about the development in China with the local OEMs quite healthy growth there. How much is this driven by battery electric cars coming into the market and exports? And how much is it driven by, I guess, more competition in China and Hong Kong being more safe?

Mikael Bratt: A quick note on that. I do not think I have a number for, to give you the breakdown, what is driven by what there. But as you said, we see export growth for Chinese OEM increasing quite significantly so, yes, mainly to Asian countries, you could say, but also to Europe. Also, the overall ambition from the Chinese OEMs to increase the safety content.

And I would say quite dynamic market here where their requests for new innovations together with us to improve content is a great growth opportunity for us, and good collaboration with our Chinese OEMs. So a strong position for us in China altogether.

Hampus Engellau: Fair enough. Maybe a last question then for me is, in this process of the automisation and digitalisation of the production, would it be possible for you to maybe share some light on where you are in that process? How far have you come and how much is left?

Mikael Bratt: Yes, I think in the Investor Day here again we had a slide there showing – I do not have it in front of me here now. But there, you saw that we have come a fair amount in certain of our product families, but still a lot of opportunities left. So, we have plenty of opportunities to continue this journey. I think in some of the product families, maybe we are in a 30-40% of the potential.

So yes, plenty of room to capitalise on optimisation and digitalisation going forward. But I can refer to that slide in the presentation deck on the Investor Day that you can see in more detail.

Rod Lache (Wolfe Research): I would like to understand what your Q4 implied margin, your guidance of 11.5% to 12% suggests for the run rate of margin if we adjusted for seasonality because we know that Q4 is typically, I think, at least 100 basis points above average due to seasonality of recoveries, maybe a few other factors. Is that the case? Is that roughly the magnitude that we should be thinking about if we are thinking about a run rate?

And then you reiterated the 12% margin objective at an 85 million-unit LVP as long as it is stable. So S&P is already there. Could you quantify what the magnitude is of the inefficiency due to instability that you are experiencing right now?

Fredrik Westin: The seasonality in Q4 is not different this year than in other years. So it is around 100, 110 basis points that we also expect this year, and then mostly of that is related to the engineering income that is seasonally higher in the fourth quarter.

The rest of the margin increase is from the structural cost initiatives we are putting in place and then the further development on the commercial recoveries with our customers.

And then on the margin walk up, I think we have to come back on that. Nothing has changed from what we have said earlier at the Investor Day or in other discussions. It is the same logic that still applies to what we have said before.

Rod Lache: Yes, I understand. I was just hoping you might just give us a sense of the burden that Autoliv is incurring right now from that inefficiency?

Fredrik Westin: I do not think we have given a number before, and I do not want to do that either now. But as Mikael said before, here is that we actually saw that in some parts of the world, especially in Europe, the call-off reliability went backwards in Q3. It was a good track throughout the year. And in, say, all other regions, it continued to improve.

But unfortunately, Europe, it went backwards. And then it has very, very different types of how that manifests itself in our inefficiency. So it is very difficult to give a number. That is why I would like to refrain from it.

Rod Lache: Okay. And just lastly, if the recall happens, as NHTSA suggesting, it obviously makes sense that Autoliv would participate in some way, supporting your customers with replacement modules. Could you just, at a very high level, talk about what typically happens in advance of something like that? Do your customers ask for engineering work ahead of time? If this were to happen, what would you guess would be the earliest that you could accommodate the industry? And how long would the process of supporting the industry to do something of that magnitude take?

Mikael Bratt: The process would be that the customer engaged and request us to quote for such an activity and, then work with any engineering adjustment needed from our side. The specific details are difficult to answer because it is unique by customer and depending on our own product portfolio here and what needs to be done there. So that is a unique case.

But I think we have shown in the past that we are capable of supporting our customers in quite significant recall situations. So I expect us to be able to do that fairly quickly, if this would happen here as well.

Concluding Remarks

Mikael Bratt: I am confident that we will deliver a substantial increase in sales, operating cash flow and adjusted operating income in the fourth quarter. We continue to advance our structural cost reductions initiatives, and we see an improving position with fast-growing OEMs as well as continued gradual stabilisation of supply chains. This forms a strong foundation for continued strong development in the years to come that support our mid-term targets.

Autoliv continues to focus on our vision of saving more lives, which is our most important direct contribution to a sustainable society.

Our fourth quarter earnings call is scheduled for Friday, 26th January 2024. Thank you, everyone for participating in today's call. We sincerely appreciate your continued interest in Autoliv. Until next time, stay safe.

[END OF TRANSCRIPT]