Interpump Group S.p.A.

3Q-3Q2023YTD Results Conference Call

Friday 10th November 2023

MODERATORS: FABIO MARASI, GROUP CHIEF EXECUTIVE OFFICER

ELISABETTA CUGNASCA, HEAD OF INVESTOR RELATIONS

OPERATOR: Good afternoon. This is the Chorus Call conference operator. Welcome and thank you for joining the Interpump Third Quarter 2023 Financial Results Conference Call. As a reminder, all participants are in listen-only mode. After the presentation there will be an opportunity to ask questions. Should anyone need assistance during the conference call, they may signal an operator by pressing "*" and "0" on their telephone.

At this time, I would like to turn the conference over to Ms. Elisabetta Cugnasca, Head of Investor Relations of Interpump. Please go ahead, madam.

E. CUGNASCA: Thank you. I am Elisabetta Cugnasca, Head of Investor Relation of Interpump Group. Good afternoon or good morning according to your time zone, and welcome to Interpump's third quarter 2023 financial results conference call. As usual, I have to bring your attention to the disclaimer slide inserted in the annex part of the presentation. I hope you were able to download it from our website. Afterwards, it's my pleasure to leave the stage to Mr. Marasi, Group CEO.

F. MARASI: Thanks, Ms. Cugnasca, and thanks to all of you for the attendance. I would like to start third quarter 2023 results comments underlining you to the right numbers, plus 4% of organic growth and 24.3% of EBITDA margin. A growth of 4% on a growth of almost 16% recorded in the first quarter '22 and a growth of almost 18% recorded in the third quarter '21, and then indeed a growth on growth is a remarkable result which underlines the strength and the resilience, the diversification has always given and was more is giving to the growth. In 2021 and 2022, Hydraulics was the growth driver. In 2023, Water-Jetting takes the baton. And second, the capability of the group to understand the market dynamics and to act consequently.

Last February, we released a guidance with a 5% organic growth, having explained that for the second part of the year, a normalization after 3 years of double-digit organic growth was to be expected. We added that in 2023, the late-cyclical nature of Water-Jetting wouldn't appear. This is exactly what happened.

An EBITDA margin of 24.3% and despite the normalization of the demand, in some market application of the biggest division of the group, the Hydraulics one, and some dilutive effect coming from acquisition in the most profitable one, the Water-Jetting, the EBITDA margin grew by 50 basis point from 23.8% to 24.3% on total, and . moreover, by 80 basis points to 24.6% on a like-for-like basis excluding acquisitions. This is the reflection of the important capability of Interpump. I quoted before, understand market dynamics and promptly adapt group operations. Improved margin to be considered easy in Water Jetting will grow organically by almost 9%. Improved margin with a growth of only 2% in Hydraulics is the best evidence once again of group capability to adapt operations with flexibility.

Diversification, capability to read the market and adapt operations and capability to convert profitability in cash are the key drivers and the key levers which allowed Interpump to consistently deliver excellence and resilience year after year in the last 30 years. We are confident that these levers would help us in the future too.

We are entering the final phase of budget process and therefore it's too early to give you a proper review of 2024, while we share with the market our initial thoughts. Growth in sales and order intake in Water-Jetting is stronger month after month. And at this stage, it's fair to say that for this division we have a visibility which cover the major part of 2024 and which make us confident in terms of sales and moreover in terms of profitability. Normalization in some market application of the Hydraulics division will go on in the remaining part of 2023 and this was already factored in the high single-digit guidance we shared last May.

We will not change our approach in terms of pricing and cost management. From one side, we will go on with our fair approach to pricing. A fair approach within the last couple of years allowed us to strengthen the relationship with the customers and to protect and expand group profitability. To the other, we will focus on flexibility which means leveraging on 2 important business model features, cost of goods sold, labour cost, and other industrial cost are almost 90% of our cost structure, second, the saturation of the internal production capability and the use of external production to face demand peak with flexibility. These elements are the base to protect profitability over the long-term.

On top of this, we will further improve cash flow generation. One year ago, we implemented actions to improve cash generation to mitigate the impacts in terms of cash of the extraordinary counter measures we adopted to exploit sales and protect profitability. These actions are bearing fruit as we will describe shortly and we can predict additional improvement in next quarters, considering the benefit of sales normalization process in terms of trade working capital and the gradual conclusion of our extraordinary post-COVID CAPEX plan.

After this snapshot, let's focus on the first quarter and the first 9 months 2023 figures, in terms of sales, organic growth of 4% in the third quarter and by more than 10% year-to-date. Growth drivers, the previous 10% year-on-year is roughly half and half between volumes and prices, a very good combination between passing the inflation on manufacturing cost to our customers and maintaining a very good utilization rate of our manufacturing capacity.

Some color on sales evolution in the third quarter from a geographical and sector application point of view. In terms of geography, speaking in local currencies and starting from top countries, USA is up more than 6%, Italy is up by around 1%, Germany is down by around 1%, Canada is up by 4% and UK up by more than 9%. Looking at the second tier region, China is down by around 1%, while India is up by around 35%. Overall indication is that Water-Jetting strong results are balancing Hydraulics normalization trend.

In terms of application markets, always speaking in local currencies, adapters industrial vehicles are up by around 12%, generic dealer up by almost 4%, agriculture and forestry is down by around 17%, earth moving machine up by around 1%, construction up by 17%, lift is down by 2% and food and beverage is up by 10%.

Some message as before. Application markets with an higher incidence of Water-Jetting are stronger, application market with an higher incidence of Hydraulics are softer due to the normalization trend in act. On this latter point, it's worth to mention that this normalization is characterized by very different nuances, for example among the most important market application quoted, adapter industrial vehicles, construction and general dealers which year-to-date represent almost 40% of the group sales in the third quarter, grew on average close to 10% and the only big weakness is agriculture, which year-to-date is around 10% of our group sales.

Diversification between divisions and inside each division. Agriculture weakness explains why among all group companies White Drive recorded the worst results in the quarter, in the third quarter in terms of sales. We were expecting this and already in August, we underlined that White Drive European activities were softer compared to the American ones. For both demand normalization and last part of factor is the organization between Poland and Germany, but to be fully transparent with you in the third quarter, trends in particular in agriculture were stronger compared to our assumptions.

Moving to profitability, EBITDA margin of 24.3% compared to 23.8% of the third quarter 2022 means that this is the best third quarter margin of Interpump history, despite 30 basis point dilution effect coming from the consolidation of the newly acquired companies. Hydraulic 22.6% is up by 80 basis points compared to the second quarter…to the third quarter 2022, which, I remind you, includes the first €4 million of the insurance reimbursement for the IMM fire in Romania. If we exclude this, margin improvement is therefore much stronger compared to the initial size, that's about 180 basis points, even better of the one recorded in the second quarter of 2023.

On top of this, margin evolution should also be appreciated taking into account the corresponding sales evolution underlined before, plus 2.3%. The different magnitude of the 2 variation underlines, once again, the group capability to adapt operations with flexibility. Precisely for Hydraulics division and precisely for the second part of 2023, we budget already the sales normalization process, and therefore, since 2023 start, we proactively worked to be ready to face this evolution, leveraging on business model flexibility mentioned many times.

In Water-Jetting, in the third quarter, we faced a dilution of approximately 70-basis points to 28.4%, driven exclusively by perimeters changes, White Drive in particular. I will give you more details on acquisition shortly. Now, I would like to underline the organic performance.

In the third quarter, the EBITDA margin of the Water-Jetting division reached 30.1% on a like-for-like basis, and that is an astonishing result. The sales mix effect, which characterized the previous 2 quarters, is still present, as the organic growth of 8.7% has shown, and we successfully managed it. The third quarter organic number, plus 8.7% on sales and 30.1% of EBITDA margin, are therefore the best evidence of the late cyclical nature of this business, and therefore, of the fundamental relevance of that and support that Water-Jetting division is representing for the entire group.

In terms of CAPEX, last August, we anticipated that the most important projects of our post-COVID CAPEX plan are getting gradually to an end. From Walvoil and Tubiflex in Italy to White Drive in Poland and U.S. to Muncie in U.S. too, and IMM in Romania too, even if this project obviously was not in our plan. Between 2021 and 2022, we built the factories, and now we are placing in the new factories new equipment, small, but interesting examples in a slide of result presentation, interesting examples because they allow us to underline the second goal of our CAPEX plan. The first one is obviously to increase production capacity. The second one is to improve efficiency and automation of the production capacity.

Increase and improvement are 2 key words. To be able to produce in a more efficient way is equally important to be able to produce more. A more efficient production is the first way to protect and improve group profitability, which is, of course, our North Star. And that are the best evidence of the group approach.

EBIT of the first 9 months of 2023 is above 20%. That is a record number. This allow us to underline that for Interpump, CAPEX is not synonymous of cash absorption, it's synonymous of growth, profitability, which usually both drive to cash generation.

Moving to free cash flow generation, it's important to underline that in summer 2022, we took the commitment to improve cash flow generation. After the impact of both extraordinary sales evolution and extraordinary countermeasures, we adopted to protect production continuity, and therefore, profitability, a phenomenon, which increased trade receivables and inventory, respectively, above group normal levels.

In the first quarter 2023, the first results were already evident. In the second quarter, the trade working capital cash absorption was reduced by more than 70%. And finally in the third quarter, the trade working capital generated cash around €6 million instead of absorption of more than €40 million in the third quarter 2022. Consequently, as of September 2023, the group free cash flow generation was around €100 million that compares with €22 million in the 9 months of 2022. Step by step, we are working to gradually go back to the trade working capital pre-COVID level we consider the best from an industrial, long-term point of view.

In terms of acquisition, after some months of ownership, please let me give you some color on the 3 acquisitions we performed until now in 2023, that are, Mouldtech and I.Mec, and Waikato. In Mouldtech, the cast iron foundry we bought in India, we started to improve working condition and existing facilities, even before the closing. And now, we are gradually implementing a CAPEX plan to enlarge production capabilities. This is aimed at reaching our mid-term goal to reduce dramatically group external dependence in terms of cast iron supply and enjoying cost benefits. I.Mec was plugged in, and its margin even still not at Water-Jetting division level, are already above group average. With our usual transparency, we have to say that Waikato is the one, which is lagging behind.

New kind of activity and business model are in some way slowing down factors in the integration process, but we are confident that activities already started, for example, the integration of Waikato commercial structure in the Inoxpa one will be bearing fruits. Who have been following us since many years probably remember that exactly 6 years ago in the third quarter 2017, the EBITDA margin of Water-Jetting division went down by 100-basis point due to the Inoxpa consolidation. You may remember that Inoxpa entered in our group with €60 million in sales and an EBITDA margin of around 19%. And we are really proud to mention that in 2022, Inoxpa sales were above €90 million with an EBITDA margin above 28%.

Finally, White Drive, not a 2023 acquisition, but an acquisition on which we took the commitment to update you on a regular evolution in terms of integration. For 2023, we targeted the achievement of a consistent 21% of EBITDA margin, all among a year after a satisfactory 2022 and a very good 2023 start. Restructuring activities implemented between Germany and Poland in the first part of 2023 did not change our assumption, but the sales evolution that is below our expectation the third quarter of 2023 is suggesting us to be more conservative. Obviously, the short-term change is not hampering our mid long-term goal to align White Drive profitability to the Hydraulics Division one and perhaps even a bit better.

These are all important details of the past months, some color on most recent trends, based on October first indication, which are particularly important because we are entering in the quarter, which has the most challenging comparison base. Indeed, in the fourth quarter 2022, our sales grew organically by 14%, with almost 18% growth in Hydraulics and more than 4% in Water-Jetting.

I have 2 points to mention. The first one is that the summer trends are confirmed, with an ongoing normalization of some Hydraulics market application and ongoing Water-Jetting strength currently with 2023 roadmap. The second is that the backlog is below €1 billion, but consistently and significantly well above 2019 pre-COVID level, and the evolution it's at all coherent with our expectation of an Hydraulic normalization and a Water-Jetting growth.

One remark of backlog is important. The backlog gives an indication in terms of visibility, not in terms of turnover. 2022 backlog was x times 2019 backlog, but in reality, 2022 sales were not x time 2019 sales. Therefore, today, we have for both divisions a visibility materially above what we had in our group before COVID and historically, even if on a different magnitude for the 2 divisions. This is the reason why some minutes ago I underlined you that in 2024, Water-Jetting will be the sales and moreover, the profitability support for the group, while we need to conclude the budget season to have a clear picture for the entire '24 for Hydraulics and therefore for the group.

After these comments, I hand over the floor to Ms. Cugnasca for the ESG updating, which, as the one of last May, reflects very important changes for our group.

E. CUGNASCA: Thanks, Mr. Marasi. While last time we spoke, I was able to be concise due to the fact that ESG action implemented in the first part of the year were being already announced and explained. Today, my ESG updating will be longer than usual because exactly today our Board of Director approves additional 2 ESG actions, perhaps the 2 most important of the 2023 to '25 ESG journey first step, building group ESG foundation, the 2023-32 decarbonisation strategy and the succession plan formalization.

2023, 2022 Decarbonisation Strategy. As you probably remember, group aims to reach 30% emission reduction in 2025, starting from 2021 level and leveraging on instruments like the split up of the photovoltaic plant construction and corporate power purchase agreement. Thanks to 2023-32 decarbonisation strategy definition process, we were able to precisely identify what is needed to confirm and to reach this goal, and moreover, we were able to define group medium long-term decarbonisation target, minus 45% in 2032, and what is needed to reach both targets, it is needed to use in a broader way, for example, other countries among Italy, instruments already foreseen and to add new ones as green energy. All of this for around €3 million of CAPEX, and less than €6 million of OPEX spread between 2023 and 2032.

Adding what we budgeted last year for 2023-25 ESG journey, the total amount of resource dedicated to our ESG part is around €30 million of CAPEX and around €9 million of OPEX in 10 years. Overall, very limited amounts compared to our dimension, our profitability, and moreover, to the magnitude of reduction we are targeting, minus 30% in 2025, and minus 45% in 10 years. This is for sure the most important achievement of these months of work, but we would like to share with you other progresses we did in our ESG part during this year.

Improvement of calculation sample, first analysis on Scope 3 emission, and a better understanding of M&A impact from an emission point of view, going step-by-step; improvement of calculation sample, 2023-25 ESG journey was worked out based on a calculation sample of 25 group manufacturing companies, 16 in Hydraulics, and 9 in Water-Jetting, which represent, in terms of 2021 data, almost 65% of group turnover. 50% of group production sites above 900 square meter, 70% of group employees and moreover close to 80% of Scope 1 and Scope 2 emission.

Leveraging on 1 year more of experience, we decided to enlarge the calculations sample, for example, having included White Drive and more

Water-Jetting companies. This allowed to increase North American and Asian analysis and furthermore to have a calculation sample that now represent in terms of 2022 data almost 80% of group turnover and almost 90% of group emission.

White Drive inclusion deserves some additional details. In terms of Scope 1 and 2 emissions, the production business model of a motor steering producer usually generates more emissions compared to the usual group production business models both in Hydraulic and Water-Jetting. This is because there is higher production integration, for example, head treatment line, printing line and manganese phosphating line.

Therefore, the simple inclusion of White Drive in the emission analysis made group Scope 1 and 2 emissions production increase. Notwithstanding that, 2025 target is not jeopardized. 2023-32 decarbonisation strategy includes all levers needed to reach both short and medium long-term emission targets. Finally, 2 remarks on this matter to avoid any kind of misunderstandings decarbonisation strategy has an improved calculation sample compared to ESG journey, but the application base is exactly the same in the entire group. They both are and they both will be applied to the entire Interpump Group. So far, we are not adjusting retrospectively [ph] ESG journey quantitative targets. In 2025, comparison to verify target achievement will be consistently made considering 2021 data baseline.

Second improvement, first analysis of Scope 3 emission, group started to track Scope 1 and 2 emission in 2017. Scope 3 emission collection starts in 2023 in conjunction with decarbonisation strategy definition. Even any of our data base needed to be strengthened through next year collection, we already developed a significant knowledge in terms both of relevance of each category, for our group, and possible initiatives to mitigate them.

For example, among the 15 Scope 3 categories, the most relevant for the group are categories 11, 1, 9, and 4. And for categories 1, 9, and 4, group is already assuming certain possible steps to implement. Vice versa, Category

11 deserves deeper and additional analysis. We are confident that next collection will allow us to strengthen this knowledge for eventual future updating.

Third achievement. Better understanding of M&A impact from an emission point of view. M&A is a crucial lever of Interpump growth strategy. Therefore, it was mandatory to approach M&A from an ESG point of view. And therefore, we performed a sensitivity analysis. So, we look back to all acquisitions executed in one division and we focus on the most relevant all in terms of emission, either in terms of group production business model representativeness. We identified two acquisitions in Water-Jetting, one for each segment, and one in Hydraulics, a company with a higher than group average emission level.

Afterwards, we assume the possible consequence of similar acquisition during the implementation horizon of the decarbonisation strategy. Despite the implementation of the decarbonisation strategy, this possible acquisition could impact the 2032 emission target significantly above the level we could reach in that year with simply organic growth. Therefore, we assumed to apply directly to such possible new companies levers foreseen for the 2023-32 decarbonisation strategy. The result was the material mitigation of the possible emission impact, almost halved.

This exercise, from one side, confirmed once again the low-emission nature, Scope 1 and 2 of group business model, to the other, underlined effectiveness of identified mitigation action. Such sensitivity exercises assure us on the soundness of our M&A strategy, even from an ESG point of view. Always speaking on M&A, to further confirm group commitment to ground its overall strategy to an ESG approach, please be aware that we will start to include ESG parameters in the due diligence and evaluation process of relevant manufacturer M&A target.

To conclude, again, one remark to avoid any possible misunderstanding. We run an M&A sensitivity to understand the soundness of one of the most important pillars of Interpump group strategy from an ESG point of view, and we are sharing these results with you because since the presentation of our ESG journey of last year, we received many questions exactly on this topic. We are not suggesting in any way that between 2023 and 2032, we are planning to make two acquisitions in Water-Jetting and one in Hydraulics. We are just reassuring you after having reassured ourselves that we can proceed without fears in making our group better and stronger following the path of the last 30 years.

Before switching to other ESG actions approved to-date. please let me draw your attention on the availability of a short presentation dedicated to 2023-32 decarbonisation strategies on our work sites.

Succession Plan Formalization, with the concrete approach that characterizes our group, we already started to address such topics last April, when leveraging on Board renewal, chairman and CEO roles were splitted and Mr. Marazzi was appointed CEO. Even if this was an important step, it was not the only one needed. It was needed to define a formal process not correlated to individual people, which would protect group organization stability and continuity in case of temporary or lasting inability of key managerial figures to perform their role. And this was done following 2 different and interconnected processes. A process we name identification and a process we name knowledge.

The first one meant define the process through which key people, key managerial people are identified and possible candidates ready for succession. Second, define procedures to be applied in such an inability case. The second one meant lay the foundation to elaborate a managerial development plan to enhance group managerial resources. This was an important step for our group considering the decentralized organizational business model we have adopted.

Summing up my ESG updating, in less than 10 months, we implemented 4 fundamental actions of our 2023-2025 ESG journey. Action will be the anchor of the work of the next 10 year and even more. No doubts that we started later our ESG path, no doubt that we are working harder in a very concrete approach to close the gap.

F. MARASI: Thanks, Ms. Cugnasca. Summarizing, the third quarter group delivered growth-on-growth with a good profitability improvement in both growth and normalized strength and very good cash flow generation exploitation, this having levered on Interpump 3 fundamental strengths, diversification, capability to read the markets and to adapt operations and capability to convert profitability in cash.

October trends are consistent with summer trend and 2023 roadmap and therefore, we confirm once again, our upgraded 2023 organic sales guidance to high single-digit and we confirm that 2023 will be the best year ever in terms of profitability margin. We also confirm our full commitment to prepare ourselves at our best to face 2024 leveraging our strength, once again confirmed by the results of the third quarter 2023.

Diversification, capability to read the market and adopt operations and capability to convert profitability in cash, these were the levers which allowed Interpump to deliver 30 years of excellence and resilience. Thank you.

OPERATOR: Are you ready for questions, sir?

F. MARASI: Please go ahead.

Q&A

OPERATOR: Thank you. This is the Chorus Call conference Operator. We will now begin the question and answer session. Anyone who wishes to ask a question may press "*" and "1" on their touchtone telephone, to remove yourself from the question queue, please press "*" and "2." Please pick up the receiver when asking questions. Anyone who has a question may press "*" and "1" at this time.

The first question is from Matteo Bonizzoni with Kepler Cheuvreux. Please go ahead.

M. BONIZZONI: Thank you and good evening. I have…would have 2, 3 questions. The very first one is I am trying to define a potential scenario of 2024. [Indiscernible] and you will provide more indication with the full year results next February I think, but I just want to share with you some elements of our reasoning. So according what you have said about the resilience, also in terms of intake of the [indiscernible], I would assume that your current scenario is for an organic growth for Water-Jetting business for 2024 of some percentage points let me say.

For Water-Jetting, for the [indiscernible] we've seen signs of weakness in agriculture but also we are starting to see I think some deceleration in trucks**,** so it's more difficult for me personally to say if the organic decline we could have next year in Hydraulic which is still 70% or more than 70% of your total sales and more than 60% of total EBITDA could be between zero and minus 5% or maybe also more than that minus 5% to minus 10%. So I want just to share with your this reference point to…or even just to understand what you are in the market you see all the data points, different customers in certain markets. So, if you would exclude or, let's say, 3 years ago probability to a decline of let's say minus 5% plus and you would say if we have decline in Water-Jetting is more limited to a low single-digit range. That's the first question.

The second question is with regards to investments and CAPEX. In the 9 months, we have you've invested €123 million of CAPEX. So this year, I think you should easily lend our €50 million which is more than 1.5 time your depreciation, but you will say that you are approaching the end of this extraordinary CAPEX phase we started already 2, 3 years ago. And so my question is what is an approximate level of investment, which you should be making for 2024 and 2025?

And my last question, is that regard the [indiscernible] outlook, something is changing for sure in general globally, something has already changed because the interest rates are much higher and you were I mean…a few quarters ago. There is an ongoing slowdown in certain business. So I assume…I believe that they have to be very careful in terms of transaction margins of a potential seller could be lower compared to the past years in which there was also a big inflation by private equity activity and so on. So, the question is what are you observing and do you expect that some M&A deals in this new scenario of slowdown and also higher interest rates could be easier to finalize for you. Thanks.

F. MARASI: Thank you, Matteo. I will start from your third question and we will…and I will go back. Regarding the M&A outlook, I confirm that we are pretty positive in this respect for 2024 and going forward because of what you mentioned, I mean, the higher interest rate that should bring more discipline in terms of multiple expectation or multiple market margin, market multiple I would say.. And then I am expecting…we are expecting a better market environment and you have also to consider that we will have a much more resources to dedicate to M&A. It is clear that in reality we never had a balanced limits or a balance constraint because we've always been very strong in terms of balance sheet, in terms of leverage.

But considering that, we will end up 2023 with our net financial position to EBITDA well below 1 time, and that in 2024, we will generate much more cash flow. We believe that we will have much more resources to dedicate and to be deployed in M&A and this is combined with a better market environment, I mean more uncertain outlook, more discipline in terms of multiple or expectation from the seller should bring to more opportunities and more deals. Then I am really confident in this for 2024 and 2025 and we are really, really prepared to catch significant opportunities going forward.

Your second question was about CAPEX. It is true that this year, we will go to a number that is close to the number that you mentioned, €150 million, €160 million, and this is like we mentioned before I would say the completion or the majority of the completion of our post-COVID extraordinary investment plan to support extraordinary growth that we have experienced in the last 3 years.

Going forward, a normalization should be absolutely expected and then I would assume that in 2024 and in 2025 we will go back to our usual range that is something around 4%, 4.5% of our sales. I mean €100 million in 2024 against the €160 million that will be our number for…probably our number for 2023.

Moving to your first question that is the most important one, that is 2024 scenario. As you know, we are entering now in our budget session and the budget will be discussed between second part of November and the first part of December, and we will release our indication and our outlook together with the full year results, next February.

In terms of general outlook, it is true that we have really differentiated outlook in the different divisions, in different business and in different application fields. I wouldn't say that tracks of other application and transmission was [indiscernible] are normalizing. The only real weakness in this moment is agriculture. Agriculture went up dramatically after COVID then in 2021 and 2022 and then first half of 2023 and if you go and see [indiscernible] results, CNH results recently approved and so on, you will see the significant slowdown in the agriculture business. And this is also the reason why the only company that is…or the company that is being impacted the most in this moment is White Drive. That is the most exposed to the agriculture application.

If we exclude this application fields, I mean, agriculture, everything else is preforming well, is resilient or is performing extraordinarily well in some Water-Jetting application. Overall, I believe it is important to mention and to underline once again how Interpump Group diversification and balance between different markets, different customers and different application fields is reducing the operating risk of the whole group.

You made a very important question asking if for next year, we should expect for Hydraulics, a scenario which is…the organic growth will be between zero and minus 5 or between minus 5 to minus 10. I will say that I will exclude the second one. I would exclude a strong slowdown. I am not excluding that, we will maintain this year results. This is something that we will see in the next few weeks, we are discussing with our most important customer 2024 plan. But based on our indication and based on the current market demand, we do not see a dramatic change in scenario, we may see some mix change, we may see that some application will go down more than someone else. But overall, I underline once again that balancing and diversification is protecting once again our consolidated results.

M. BONIZZONI: Thank you.

OPERATOR: The next question is from a Bruno Permutti with Intesa Sanpaolo. Please go ahead.

B. PERMUTTI: Yes, good afternoon, everyone. I have a question related to the price [indiscernible]. There are…there is different factors that considering your statements that seem to support the profitability next year. I mean it's probably the sales mix, and probably the new capacity. So, I like to understand if you see prices, how do you see the prices scenario? So, this could be positive neutral or negative effects for, for next year margins? And you believe that cost inflation could be outbalanced from these several other factors that could in fact sustain sustainable profitability?

And a second question with regards the cash generation for the fourth quarter and next year. I'd like to understand, what could be the driver above all in fourth quarter if you believe that you will be able to bring back your stock levels at a lower level compared to the current one and what are the level that you have in mind to use to continue to bring down the trade working capital.

F. MARASI: Okay, thank you, Bruno. In terms of pricing, we have to consider that we are seeing different trends for even in 2023, because while it is true that energy costs went down significantly this year, we also have to consider that raw material cost went down a bit. But labor costs that are catching up with inflation that we have seen in a couple of year that we have experienced are counterbalancing the reduction in cost of production.

And then, I would say that for 2024, we should expect a flat price effect. I wouldn't expect any significant increase or any significant reduction, if we consider the group as a whole. Of course, we will have once again a different scenario or a different situation. I have in mind that for example, we have some company for example, the Cylinders one, in which the incidences of raw material is higher than the incidence of labor cost, and then if raw material will go down, we will have to be ready to give back something to our customers.

We mentioned many times that we have "unknown as approach to pricing." We have increased the orders in the last couple of years, prices whenever was necessity and whenever we had evidence that we had a price increase to be transferred. If we will have a significant reduction in some bill of material or in some manufacturing costs, we will have to be ready to give back something. But overall, if I have to give you a number, I would expect a 0% price effect for 2024.

In terms of cash flow generation, I believe that is very, very important to underline that the 2 main drivers for the expected significant increase of the cash flow generation are the normalization of the net working capital and the CAPEX. As you know very well, net working capital and CAPEX absorbed huge amounts of money in the last couple of years, and are being normalized in the new scenario.

Net working capital, for example, breached 40% on sales, and that is a very, very important level. And we expect that between '24 and '25, we will go down to a more normal level of 35%, 36% that was our pre-COVID, usual range. And this is a significant contribution.

The second aspect is a CAPEX, we have already commented that in '24 and '25, we expect a more normal CAPEX number that will be 4%, 4.5% of our sales against a far higher number in '22 and '23. And if you will make the math, maintaining a very good EBITDA margin and a very good EBITDA in absolute terms and considering what I have just underlined in terms of networking capital evolution and CAPEX expectation, you will see our element will be the expected cash flow.

B. PERMUTTI: Thank you. And if I may, a very quick follow-up, on the project, you mentioned of the shutdown of Germany concentrating in Poland and in Romania, 2004 will be at regime have to complete them?

F. MARASI: No, both projects were completed in the third quarter, I mean the German plant of White Drive was completely shut down in August of '23. And the Romanian plant of IMM is fully operating already from September 1, then in 2024, we will be in these 2 plants, in these two situation completely at regime.

B. PERMUTTI: Thank you.

OPERATOR: The next question is from Alessandro Tortora with Mediobanca. Please go ahead.

A. TORTORA: Yes, hi, good afternoon to everybody. So, I have 3 question, if I may. The first one is related to the Water-Jetting profitability considering what you mentioned before, is it fair to say that companies are like, for instance, are currently enjoying a positive, nice cost spread, and probably are having let's say a higher profitability compared, to the past? This is the first question?

And I go with the other question? So, the second question is related to White Drive, let's say, the safe trend, I didn't get, let's say any indication so just to understand if you still expect some growth in the [indiscernible] for White Drive?

And then also can you comment also little bit on White Drive, in terms of let's say output because many companies also in the reference market [indiscernible].

And the last question is India. I had let's say [indiscernible] between nations a very good performance of India. Is there any specific plan you have on India in terms of maybe capacity or just let's to understand what's your view on India considering the strong let's say the capital, the culture of performance between India and China? Thanks.

F. MARASI: Okay, thank you. Thank you, Alessandro. Now regarding Hammelmann, as you know very well, Hammelmann has always been one of our most profitable company. The real news is that in the last few quarters, we have seen a boom in demand in Hammelmann. And Hammelmann month after month, is reaching an unprecedented level of business and an unprecedented level of order intake. And then we have huge expectation going forward, and also for 2024. And if I have to add a comment, that is a detail that is important, the 30% plus EBITDA margin for the third quarter 2023 of Water-Jetting on a like for like basis has been driven by Hammelmann.

Then, once again, I want to underline how relevant is Hammelmann for our group for supporting, and for counterbalancing other trends. IMM has been lagging behind in the last, in '21 and '22 in terms of growth, has always been spectacular in terms of profitability. Now it's taking the baton also for driving the growth, thanks to new application fields, thanks to the late cyclical nature of a significant part of Hammelmann businesses that is the project one, then Hammelmann is once again one of our most important dealer.

White Drive,….

A. TORTORA: Sorry, if I interrupt you because on Hammelmann point, considering that Hammelmann also has is one of the reference market to the general one, can you help me understand [indiscernible] new or the current application helping the company to get let's say this acceleration growth.

F. MARASI: Now, the reality is Hammelmann is a German company, it's that what is based in German, also Hammelmann is a global company, and the driver the demand and the unprecedented order intake is coming from all over the world, from a very differentiated application field and from a very differentiated range of customers. And then I wouldn't associate Hammelmann to Germany, not at all.

Moving to While Drive and Walvoil, White Drive is the company that is the most exposed to the agriculture application. In Walvoil, the exposure to agriculture is below 20%, in White Drive it's I would say 35%. And this is the reason why the third quarter turnover of White Drive went down by a few percentage points, while, Walvoil is still growing. Just to mention a couple of numbers, Walvoil is up double-digit in the 9 months…in the first 9 months of the year. And also the expectation being Walvoil much more balanced in different application fields or in a more diversified application field. We believe that Walvoil will be more resilient in the incoming months.

Moving to your last question that is India, I am very proud to say that India is performing spectacularly and luckily, we have always been more exposed to India than to China. India is performing incredibly well. We have 3 major operations, 3 major activities in India, that are Inoxpa subsidiary, the Interpump Hydraulics subsidiary and above all, Walvoil group subsidiary. And all these 3 companies are performing very, very well. Indian market is still growing and expectations for 2024 are very, very strong.

India in this very answer, the macroeconomic scenario with a lot of uncertainty is one of the most important, most strong spot all around the world. And this is also the reason why we invested with an acquisition this year and we are prepared to invest more in the Indian market because the mid-term opportunities are very positive. And we have the right organization, the right structure and the right team in place.

A. TORTORA: Okay. Thanks a lot. Thanks Fabio for the answer.

F. MARASI: Grazia, Alessandro.

OPERATOR: The next question is from Domenico Ghilotti with Equita. Please go ahead.

D. GHILOTTI: Good afternoon to everybody. I have a few questions. The first is on the backlog. If you can give us a sense of what percentage is, let's say, Water-Jetting and how much is Hydraulic and what are you seeing in Hydraulics? So, I mean are just…are clients just postponing some orders? Do you see some cancellations, given the sudden change in the scenario? Also what's going on there?

On the free cash flow generation, for the full year, if you can just comment on what do you expect in terms of working capital reduction, if you see still room for getting some working capital in Q4?

And third question is related to Waikato. So, if you can just give us some additional comments on what's going on there, if it is just a matter of restructure or it was a matter of end markets that have been changing?

And last, I saw in your presentation that the APAC region in Hydraulic was actually down and you are commenting China and India in general, not just in Hydraulic, that were neutral or even very positive and so I am trying to understand what's going on there, if it is a matter of division or there are other markets in APAC that are suffering a lot?

F. MARASI: Okay. In terms of backlog, the breakdown is very similar to the breakdown of sales. I mean 25% is Water-Jetting and 75% is Hydraulics. One year ago, the breakdown was seeing a different balancing because the lead times in Hydraulics skyrocketed and we mentioned many times that we have companies with times that were close to one year or even higher and now with the normalization, we are seeing a normalization in the breakdown between the 2 division. I mean the lead times are going back to normal in both division and this is the reason why we are seeing a reduction or a normalization in the backlog in water…in Hydraulics, sorry, and the amount increased in Water Jetting, that is giving us more visibility in these periods.

In terms of free cash flow, it is fair to say that this normalization trend in net working capital on sales will continue in the fourth quarter. I don't have a precise number or precise target for December '23. I already commented that from 40 plus percent peak that we reached at the end of 2022, we are going down and we will go down to, let's say, 36% in a couple of years. I don't have precise numbers or I don't have a monthly target to be reached, but for sure the free cash flow generation in 2023 will be much higher than the one reached last year and we expect another significant increase in 2024.

Moving to Waikato, Waikato is the last acquisition, it's an acquisition in which we were already prepared to make some intervention because Waikato was very successful in the Australian and New Zealand market, but had to be [technical difficulty] internationalization process and this is what we are doing. We are reconsidering international footprint of Waikato together with international footprint of Inoxpa, in order to find synergies, in order to try to announce the already existing organization, in order to improve the forces and to improve the profitability of Waikato and of the entire division.

Like I have already commented earlier in this meeting, when we acquired Inoxpa, Inoxpa was well below 20% EBITDA margin and Inoxpa will close this year, very close to 30% EBITDA margin and the reality is that in few years, we have increased the profitability of Inoxpa by 10 percentage points, 1,000 basis points.

This is not happening overnight. This will not happen overnight in Waikato, but we are very confident that we will be able also thanks to our approach, to our way of management, thanks to the synergies that we will be able to deploy with our flow-handling division and Inoxpa in particular, we are really confident that Waikato will improve significantly its current performance.

D. GHILOTTI: So, if I understand properly, the current performance is also a matter of the integration of the commercial subsidiaries that is disrupting a little bit the sales and not an end-market that is completely…something or…

F. MARASI: Yes, together with the running market that is now booming because Waikato in terms of application has a significant exposure to the milking system and the application and the price of milk went down this year, then we have a combination of factor. But what is more important is that we are adapting Waikato's structure and we are integrating…we will be integrating some Waikato, in particular international operation to our existing operation in order to achieve better organization and a better performance.

D. GHILOTTI: Okay.

E. CUGNASCA: In term of your last question, please be aware that while China is included in what we call Far East, Oceania. India is included in rest of the world. So, India's turnover is not able to offset Chinese turnover because they are recorded into different geographical lines. In Far East, Oceania, we have China that is quite weaker and until now, South Korea that is the second-most important country in this area is still not able to offset the Chinese performance. So, if the…size, the China performance is driven by China while rest of the world performance is driven by India.

D. GHILOTTI: Okay. And it's just a follow-up on my first question. So, on the backlog for the Hydraulics, so I'm just trying to understand if they are very…there is any, say, cancellation of orders or just say, normalization and so you don't order until you get something that you have been waiting for several months. So, it's…you're not in a hurry to push new orders.

F. MARASI: No, it's the…the point is that is a normalization of the lead time. If one year ago, we had a lead time of 12 months, it means that one year ago, our customer had to place order for 12 months in advance. If today, thanks to our higher manufacturing capacity, to our more efficient supply chain and the more reliable transportation system, the lead time is on a more normal level, I would say, 6 months or 8 months, our customer don't need any more to place order for 12 months in advance. And then the reduction that we are seeing is a real normalization. Realities are reduction in terms of visibility, but this is not meaning that we are seeing a dramatic reduction in the month after month business.

D. GHILOTTI: Okay, thank you.

OPERATOR: As a reminder, if you wish to register for a question, please press "*" and "1" on your telephone. The next question is from Michele Baldelli with BNP Paribas Exane. Please go ahead.

M. BALDELLI: Hi, good afternoon to everybody. I have only one question on this backlog evolution, just to understand on the pricing side, given that there was this kind of [indiscernible] on the orders. I should…should I assume that this pricing was fixed at the time of the order and it was not then revised, even if this relates with OEMs to contracts with cost [indiscernible] agreement and therefore if their material has gone down in the last 3 months [indiscernible] water set. How should I think about it?

F. MARASI: Yes, you know because we have already commented in several quarterly conference calls previously that of course, we fix price whenever an order is placed, but we have historically applied price increase whenever was necessary, not from the new order that you will place from a certain date onward, but for the deliveries from a certain date onward. Otherwise, we have a 12-month delivery time or a 12-month lead time. It would have not been possible in 2021 or in 2022 to currently transfer the price increase to the customer.

And then we have always been very disciplined in applying price increase whenever was necessary considering the delivery days and not the order placed. This is the same that is happening now because going forward, I believe that we will always have to apply this kind of strategy. With some customers that are really a minority, we have some indexation to some raw material or to some manufacturing cost including labor cost.

And as I have said before, the 3 most important factor costs that are raw material transformation cost and energy and labor cost are moving toward different dynamics that are counterbalancing each other. Then we will see some minor reduction or some minor increase with customer with whom we have indexation and contracts. But overall, if we consider the consolidated perspective of the group, I do not expect any significant price increase or price reduction for '24.

M. BALDELLI: Thank you for the clarification.

E. CUGNASCA: Okay. Thank you very much for all your time and your attention and speak up in February. Have a nice evening.