Q3 Report 2022

Friday, 21 October 2022

Introduction

Anders Trapp

Vice President, Investor Relations, Autoliv

Welcome

Welcome everyone to our Third Quarter 2022 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, IR.

During today's earnings call, Mikael and Fredrik will, among other things: provide an overview of the strong sales and margin recovery in the third quarter; give an update on the price negotiations; outline the expected sequential margin improvement in Q4; 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.

Safe Harbour Statement

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, available on autolive.com and in the 10-Q that will be filed with the SEC.

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 now hand over to our CEO, Mikael Bratt.

Q3 Overview

Mikael Bratt

CEO, Autoliv

Q3’22 Key Highlights

The Q3 performance is an important step towards our medium-term targets

Thank you, Anders. Looking on the next slide. I would like to recognise the entire team for delivering a strong quarter, which I believe reflects our strong execution culture.

As the market leader, we are building resilience and strength in turbulent times. Our actions initiated earlier in the year are creating both short-term and long-term improvements and enable us to build an even more competitive position, despite the challenging macroenvironment.

We continued to negotiate higher prices to compensate for inflationary pressure. We also achieved another strong outperformance versus LVP despite a negative regional mix. Our sales in the quarter reached over US$2.3 billion, the highest so far for a third quarter for our current business structure. This is despite recessionary light vehicle sales volumes in Europe and 8% currency headwind.

We also achieved a strong profit recovery, increasing adjusted operating margin to 7.5%. Our strong performance in the third quarter is especially encouraging, considering the market conditions continued to be challenging, with almost 2 percentage points adverse currency effects, as well as significant inflationary pressure and high customer call-off volatility.

We generated a strong operating cash flow. The leverage ratio improved to 1.6 times. In the quarter, we paid US$0.64 per share in dividends and repurchased and cancelled 260,000 shares. Our Q3 performance enables us to update our full year indication for the adjusted operating margin to the upper end of the indication. We expect continued sequential margin improvement in Q4 through price increases, cost reduction activities, as well as a higher LVP and engineering income.

The Q3 performance and the expected Q4 development strengthens our confidence in our midterm targets. In addition, we expect that our balance sheet and positive cash flow trend will allow for higher shareholder returns.

Price Negotiations

Looking now on an update of the inflation compensation negotiations on the next slide. To support a sustainable business model in an inflationary environment, we continue to work closely with customers to secure price increases to compensate for inflation, volatile light vehicle production and supply chain disruptions.

We have reached agreements in more than 90% of the raw material related price adjustment discussions that we initiated earlier. Price adjustment discussions with our customers for cost increases related to labour, logistics and utilities are progressing. We are also implementing greater pricing flexibility into new and running contracts with our customers to account for changing raw material costs.

Now, about half of our contracts contain raw material clauses. This is an increase from around 20% before we started the negotiations. The clauses should provide more stable and predictable earnings going forward, as changes in costs should be more aligned with changes in price.

Cost Control Measures

Build an even stronger position despite the challenging macro environment

Looking now on our cost control measures on the next slide. We continue with strict cost control measures, controlled hiring and footprint effectiveness. As a result of these activities, headcount increased only by 9% year-over-year, whereas sales grew organically by 32% during the same period. The increase also reflects preparations for the expected strong sales growth in the fourth quarter.

Also, we continue to execute on our capital efficiency programme to improve trade working capital. Considering the uncertainty of the market development, keeping a high degree of flexibility and agility is essential and allows us to be an even stronger company, long term.

Q3'22 Financial Overview

Strong sales increase and profit recovery

Looking now on the financial overview on the next slide. Our consolidated net sales of US$2.3 billion was 25% higher than in Q3 2021. Adjusted operating income, excluding costs for capacity alignments, increased from US$103 million to US$173 million. The adjusted operating margin was 7.5% in the quarter, around 2 percentage points higher than last year.

The higher operating margin was mainly a result of higher prices, operational leverage on higher volumes, as well as cost saving activities. Operating cash flow was US$232 million, which was US$43 million higher than the same period last year, mainly due to improved working capital and higher net income.

Q3’22 Sales Growth and Regional Sales Split

Looking now on our sales growth, more in detail, on the next slide. Although currency translation effects had a negative impact of 8%, the third quarter consolidated net sales increased by more than US$450 million to US$2.3 billion. Retroactive pricing contributed with approximately US$13 million and price/volume mix contributed with almost US$600 million in the quarter. As a result, the organic sales grew by more than 32% in the third quarter compared to last year.

Looking on the regional sales split, Asia accounted for 42% of sales in quarter, North America for 34% and Europe for 24%.

Q3’22 Organic Sales Growth – Outperforming Global LVP by 4pp

Looking at our organic sales growth per region on the next slide. Our organic sales in the quarter came in as we expected in the beginning of the quarter, but with a different region mix, with higher sales in China and Europe, offsetting lower-than-expected sales in Japan and America.

According to S&P Global, light vehicle production increased by 29% year-over-year in the quarter. This was almost 7 percentage points better than expected at the beginning of the quarter. All of the higher-than-expected volumes came in China and rest of Asia while volumes in higher-content-per-vehicle markets, North America, Europe and Japan, were lower than expected.

Despite the negative regional light vehicle production mix, we outperformed global light vehicle production by around 4 percentage points. Based on the latest light vehicle production numbers, we outperformed in Europe by 11 percentage points; in Americas by 7 percentage points; and in Japan by 6 percentage points. Sales in China outperformed light vehicle production despite a negative mix with manufacturers of low end vehicles benefiting from the latest tax incentives on EVs and cars with engine displacements of up to two litres.

Supported by recent launches and a positive region mix, as well as further price increases, we see sales outperforming light vehicle production even more in Q4.

Q3’22 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 launches, especially in Europe and China. The models shown on this slide have an Autoliv content per vehicle from approximately US$95 to more than US$400. The long-term trend to higher CPV is supported by the introduction of front centre airbags on five of these vehicles.

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

Financial Update

Fredrik Westin

CFO, Autoliv

Q3'22 Financial Overview

Thank you, Mikael. This slide highlights our key figures for the third quarter of 2022 compared to the third quarter of 2021.

Our net sales were US$2.3 billion. This was 25% higher than Q3 2021, and 11% higher than Q2 this year. Gross profit increased by 28% to US$383 million, or the gross margin increased to 16.7%. The gross margin increase was primarily driven by higher prices, partly offset by cost inflation, currencies and the volatile light vehicle production. In the quarter, we made US$2 million in provisions for capacity alignment activities.

The adjusted operating income increased from US$103 million to US$173 million. And the adjusted operating margin increased from 5.6% to 7.5%. The operating cash flow was US$232 million. And I will provide further comments on our cash flow later in the presentation.

Earnings per share diluted increased by US$0.53, where the main driver was US$0.59 from higher adjusted operating income, partly mitigated by US$0.06 from financial items and non-operating items. Our adjusted return on capital employed increased to 18% and the adjusted return on equity to 17%, up from 11% and 10% respectively.

We paid a dividend of US$0.64 per share in the quarter, same as in the previous quarter, and repurchased around 260,000 shares for US$20 million under our stock repurchase programme.

Q3'22 Adj. Operating Income Bridge

Looking now on the adjusted operating income bridge on the next slide. In the third quarter of 2022, our adjusted operating income of US$173 million was US$70 million higher than the same quarter last year. The impact of raw material price changes was a negative US$96 million in the quarter year-on-year. FX impacted the operating profit negatively by US$41 million or almost 2 percentage points. This was a result of translation effects due to the stronger US dollar and transaction effects mainly relating to the strong US dollar versus the Japanese yen, Korean won and the euro.

SG&A and RD&E net combined was US$13 million higher due to higher costs for IT and application engineering as well as timing of engineering income. The profit increase was driven by improved pricing, high volumes, as well as our strategic initiatives, partly offset by the significant headwinds from raw materials, foreign exchange, call-off volatility and general cost inflation.

As a result, the leverage on the higher sales, excluding currency effects, was within the range of the normal interval of 20-30% despite the substantial headwind from raw materials.

Cash Flow

Reversing the negative effects on working capital from Q2

Looking now on the cash flow performance onto the next slide. For the third quarter of 2022, operating cash flow increased by US$43 million to US$232 million compared to last year, mainly due to strong performance in working capital and the higher net income.

During the quarter, trade working capital improved by US$65 million, despite the steep ramp-up in sales. The improved trade working capital was a result of improved payables in part due to our capital efficiency programme. In the quarter, the volatile light vehicle production and logistics challenges continued, and it drove inefficiencies in inventories.

The inefficiencies in inventory continued to be in excess of US$100 million at the end of the quarter. Our ambition is to eliminate these inefficiencies as soon as possible, which does require further stabilisation of the supply chain and call-off patterns from our customers.

For the third quarter, capital expenditures net increased by 47% to US$164 million. In relation to sales, it was 7.1% versus 6.0% a year earlier. The higher level, to some extent, reflects a temporary catch-up of investments that were delayed during the pandemic. It is also related to the ongoing footprint activities and capacity expansion for growth, especially in China.

For the third quarter of 2022, free cash flow was US$68 million, US$9 million lower than a year earlier, driven by the higher capital expenditures. The cash conversion over the last 12 months was around 25%. In the quarter, we paid US$56 million in dividends and again, repurchased shares for US$20 million. In the fourth quarter of 2022, the timing of payment of customer compensations and seasonality of engineering income are expected to support the positive cash flow development.

Supporting Increasing Shareholder Returns

Value Creation Remains Core

Now looking on our shareholder returns on the next slide. Autoliv has shown in the past several years its ability to generate a solid cash flow in a difficult market environment, with COVID lockdowns, the war in Ukraine, industry supply chain challenges and substantial decline in light vehicle production. We have historically used both dividend payments and share repurchases to create shareholder value.

Historically, the dividend has usually represented a yield of approximately 2-3% in relation to the average share price. Since beginning of 2019, we have reduced the net debt significantly, as well as returned US$700 million directly to shareholders. This includes stock buybacks of around US$60 million as part of the stock repurchase programme that we announced at our Capital Markets Day in 2021.

We expect that our balance sheet and positive cash flow trend will allow for increasing shareholder returns.

Debt Leverage Ratio

Now looking onto the next slide. The leverage ratio at the end of September 2022 was 1.6 times. This was a reduction from the 1.7 times in the previous quarter, as our 12-months trailing adjusted EBITDA increased by US$58 million and our net debt decreased by US$36 million.

Strong Liquidity Position

Looking at the liquidity position, we go to the next slide. At the end of the quarter, we had a significant liquidity cushion of approximately US$1.6 billion in cash and unutilised committed credit facilities. Our unutilised US$1.1 billion revolving credit facility is with 11 major banks. This was refinanced in May of this year and matures in 2027, with an extension option to 2029.

To minimise refinancing risks, we have diversified our long-term funding sources and we also have a maturity profile that is well spread over the coming years. None of the credit facilities are subject to financial covenants.

Our Response to a Potential Shortage of Energy

The total energy use in 2021 was 943 GWh

Now looking at our energy usage, on to the next slide. We are continuously monitoring the development of the energy markets and we have taken actions to secure supply and to lock in prices. The energy issue is mainly a European challenge. The cost for the energy used in our facilities in 2021 for the company overall correspond to approximately 1% of sales. Of our total energy use, 66% was purchased electricity, and 27% came from natural gas.

Autoliv does not generally use gas for its manufacturing processes. It is mainly used for heating at some of our facilities. Our main concern at this stage is the potential impact that a shortage of gas or electricity might have on the industry supply chain, especially in Europe.

Currently, we do see a slight easing of prices in Europe due to the steady inflow of gas, mainly LNG, and recent decisions to activate nuclear power plants again. From the remaining of 2022, energy prices are locked in. Contract negotiations for 2023 are completed in all regions, except for Europe.

In Europe, we have locked in most of the prices for the first half of 2023. Several of them are new green energy contracts. We are still negotiating in a few countries for the second half of the year.

I now hand it back to you, Mikael.

Overview

Mikael Bratt

CEO, Autoliv

Light Vehicle Production Outlook

Near-term outlook is supported by continued strong performance in China and Rest of Asia

Thank you, Fredrik. Looking now at the LVP development on the next slide. Most of the auto industry continues to operate at or near recessionary levels, impacted by supply chain challenges. For example, due to lack of new vehicles, European registrations year-to-date is approximately 30% lower than for the same period in 2009 during the financial crisis.

For the fourth quarter of 2022, global light vehicle production is expected to grow by 3% compared to the same period in 2021, according to S&P Global. Sequentially, LVP is expected to improve by 4% compared to quarter three, as the availability of automotive semiconductors is expected to improve, although not as much as previously anticipated.

In North America and Europe, the near-term production forecast continues to be limited by automakers' ability to produce, not by demand. In China, light vehicle production is supported by robust EV sales and the effects from tax incentives on certain new vehicles.

According to S&P Global, full year global 2022 light vehicle production is forecasted at 79 million units, representing year-over-year growth of 6.8%.

Business Outlook Q4'22

Operating margin progression sequential improvement

Now, looking on the Q4 business outlook on the next slide. As illustrated by this slide, we have been able to gradually improve the adjusted operating margin from 3.2% in the first quarter to 7.5% in the third quarter of 2022. This is despite continued headwinds from raw materials and other inflationary costs.

The slide also shows the substantial year-over-year improvements in Q4 that is implied by our full year indication. The main reasons for the sequential improvement are the price increases and higher volumes, as well as our strong focus on continuous improvements throughout the organisation and our strategic roadmap initiatives.

As implied by our full year indication, we expect the sequential margin improvement trend to continue in Q4. In addition to higher prices, continued volume recovery and cost reduction initiatives, we expect positive seasonal effects from engineering income.

Although uncertainties continue to affect the industry volumes, we expect to significantly outperform light vehicle production in Q4. To put things in context, this year has been dramatic, especially in Europe. The year started with light vehicle production expected to grow by 17% in Europe, while now, nine months later, it is expected to decline by 2%. Additionally, we see we were globally affected by volatile light vehicle production with late changes to call-offs, the war in Ukraine and the challenging supply chain, which created disruptions and substantial cost increases.

While we continue to challenge ourselves to further improve, I am pleased that our performance in such a dramatic environment enables us to guide towards the upper end of the adjusted operating margin range.

Full Year 2022 Indications

Looking at the updated full year 2022 indications on the next slide. Our full year 2022 indications exclude costs and gains from capacity alignment, antitrust related matters and other discrete items. We are adjusting our full year indication for adjusting operating margin to the upper end of the indication range of 6-7%, reflecting our Q3 performance and the shorter time span remaining of the year.

The updated indications assume that full year 2022 global light vehicle production will grow around 6%, and that we achieve our targeted cost compensations plus some level of market stabilisation. We expect sales to increase organically by around 15%. Currency translation effects on sales are assumed to be around a negative 6%. Operating cash flow is expected to be around US$700-750 million.

Turning to the next slide. This concludes our formal comments for today's earnings call, and we would like to open the line for questions.

Q&A

Mattias Holmberg (DNB): Hi everyone. Thank you. Two questions for me. I really appreciate the details you gave on the new pricing agreement and this might be a dumb question, but to make it really clear, let us say we have a scenario where the prices fall or rise by x percent. Can you walk us through the difference of how your selling prices would change in the contracts? Do you have these raw material prices versus the ones where you do not?

And my second question is on net working capital in relation to the inefficiencies in inventories in excess of $100 million. How does this relate to the $800 million, I think you mentioned, capital efficiency programme that you talked about at the Capital Markets Day last year and how far you have progressed here? Thank you.

Mikael Bratt: Thank you for your questions, sir. Let me start with the pricing question. What we are stating is that we have come through 90% of the contracts to be negotiated around the raw material. And in those negotiations, we have increased what we then call compensation clauses for the future and connecting that to the development of raw material so we have a better balance.

It is difficult and I cannot give you a very detailed breakdown on that because each agreement has its unique details. And what we are focusing here, of course, is to make sure that we have a balance between our supplier base and our customer base and respective raw materials. But we have a better position today than what we had in the beginning of the year in relation to that. I cannot, unfortunately, give you more details than that.

And when it comes to net working capital, I will ask Fredrik to take that.

Fredrik Westin: Yes, on the US$800 million, we did connect that also with the midterm target, so the timeline 2024. You can also see that from the payable side, we are progressing very well. So I would even say we are ahead of target there, if you look at timing wise. On the inventory side, we have the right initiatives in place but unfortunately the effects are not where we want them to be because of both the volatility on the supplier's side, but also the call-off patterns on our customers' side. Meaning that we cannot get the inventory out that our setups would enable us to do because we have to operate at higher safety stock levels. But should the volatility come down, then we would expect that this allows us to operate at a better efficiency level than what we have right now.

So I would say from an initiative's point of view, it is on track but unfortunately from the results point of view, it is somewhat delayed because of the current market environment.

Mattias Holmberg: Great, thank you both.

Mikael Bratt: Thank you.

Colin Langan (Wells Fargo): Thanks for taking my questions. As we are looking at Q4, and I think your guidance implies something close to a 10% if we go to the midpoint in Q4, I think you highlighted some seasonality. Is there any retroactive pricing help there and anything that would prevent us from taking that in any material way and not annualising that as per your margin for 2023?

Fredrik Westin: You saw already now the third quarter that the retroactive part on the pricing and negotiations was already smaller than in the second quarter. And I would expect that the fourth quarter would be even smaller than the third quarter. So it is not a matter of higher retroactivity or something that then increases the margin sequentially. It is the slightly higher volumes that we expect for the fourth quarter versus the third, and that is particularly in Europe and Japan; it is a further improvement of the price position; and then the seasonality on the higher engineering income, which is a typical pattern for our company, that are the main drivers for the fourth quarter.

Colin Langan: As we are thinking about, let us say production is flat in 2023, what are the other key pieces we should be thinking about of how your margins should trend? Because obviously it has been on a pretty great trajectory so far, sequentially. You have continued pricing help? Should there be more help next year? It looks like the inflationary headwinds are not what they were at the beginning of the year, so do they actually become tailwinds next year? Restructuring production volatility. There seems like a lot of tailwinds. Is there any way to maybe frame some of those issues if next year is flat but steady production?

Mikael Bratt: I think when it comes to 2023, we will come back with more commentary around the progression as we get to the Q4 presentation, as we usually do. It is too early to comment that, but I think what we are showing here in the quarter is really that we are really focusing on, first of all, the price discussions, but our job internally is really to continue to work with our cost base and drive the efficiencies here. And we have talked on the basis here, which is our strategic roadmaps to drive efficiency across the whole value chain and additional cost focus that we announced earlier in the spring.

Of course, there is still a lot of uncertainty out there, as we have alluded to also in the Q3 presentation, that we do not have behind us yet. And we had talked about the volatility, labour challenges and component challenge, etc. I think we will have to come back and give you more details when the time comes in the beginning of next year.

Colin Langan: Okay. Thanks for taking my question.

Chris McNally (Evercore): Thanks so much and I appreciate it. Maybe if we can focus on FX headwinds, particularly it looks like you have, in the short term, a transactional headwind from the Japanese yen in terms of exporting inflators from the US. Typically, FX is washed out for you but obviously, it is extreme moves in the currencies. Could you give us an idea, is this something that you can work around from global supply, or should we think this is going to be a headwind as long as the FX is going against you in the short term?

Fredrik Westin: Yes, as we say here, we have a total currency headwind of US$42 million in the quarter; around about $25 million of that is from transactional effects. And as you said, the main reasons are the Japanese yen, which has weakened around about 30% year-over-year against the dollar. But also, as I mentioned, the Korean won and the euro. Especially in Asia, we do have FX clauses with a number of customers, so that should compensate for some of these developments. But should the FX rates stay where they are right now, we would also expect a negative impact here in the fourth quarter. And then we would look into more longer term solutions should the rates maintain at this level.

Chris McNally: There is FX clauses for some of the Asian contracts but, like anything, there is probably a delay and there is probably some gaps. So, again, an issue in Q4 as a headwind but there may be some recovery, if I think about 2023.

Mikael Bratt: Yes, correct.

Chris McNally: Perfect. And then to always to revisit, your 12% medium-term margin target still looks like it holds once production normalises, whatever that is, 89 million plus. I think the raw materials, you have done a great job of price versus raw so that seems like it is also another 'check the box'. Maybe this FX is a little bit of a headwind, but I wanted to always confirm that the 12% looks on track once we get production normalising again.

Fredrik Westin: Yes, I think as we are stating in the Q3 report, that this quarter is an important steppingstone towards our midterm targets and the framework around 12% that we have announced, at least $85 million vehicle production level, and that we have a net effect of raw material prices at the 2021 year's level is still valid. Yes, absolutely.

Chris McNally: Okay, great. Thank you so much.

Mikael Bratt: Thank you.

Joseph Spak (RBC Capital Markets): Thanks everyone. I totally appreciate that you want to punt on 2023 until we get to next quarter because there is still some moving pieces, but as mentioned earlier, the implied fourth quarter margins are close to 10%. Fourth quarter, I know typically has that 100-150 basis point from the RD&E income. If we factor that in, and all the other actions you have taken, is something around 9% the right base we should think about and then we need to consider all those other uncertainties on pricing, volume, commodities, FX, etc.? Is that how we should start thinking about it?

Fredrik Westin: I am sorry, I think my answer has to be the same as before. We cannot really give you any comments around 2023 until we get there. But, of course, as you said yourself, it is a lot of moving pieces in the external environment that also makes it difficult now to draw too big conclusions. But what I can say is that, I feel comfortable with what we can control, that our team is doing that well, and that we are moving forward in the right direction. And as I said, Q3 is an important steppingstone on that directional movement and we will come back with more detail later.

Joseph Spak: Maybe to simplify the question then, is that right that that fourth quarter has about that 100-150 basis points RD&E benefit?

Fredrik Westin: Yes, sounds about right. Yes.

Joseph Spak: Okay. The second question then. You mentioned the 5 percentage point hit from raw materials in 2022. Pro forma for the way all the new contracts are written, what do you think that would have been in 2022?

Fredrik Westin: I do not understand the question.

Joseph Spak: You are expecting a 5 percentage point hit from raw materials in 2022, right? But through to the year, you have formed new contracts that can compensate you for raw materials. If those had been in place, starting on January 1, what do you think that margin hit would have been for the year?

Fredrik Westin: Let me try to answer it this way. As we said, we have settled more than 90% of the negotiations related to raw materials. And we have done that at a level that is satisfactory for us to offset the raw material headwinds that we have experienced. With that, we are where we think we should be when it comes to the raw material compensation at the moment.

Joseph Spak: Okay. It would have been arguably somewhat negligible. Obviously, there is other inflationary pressure but strictly on the raw materials, it would have been pretty minor headwind.

Fredrik Westin: Had we had this from the beginning, yes.

Joseph Spak: Okay. Thank you very much.

Agnieszka Vilela (Nordea): Perfect, thank you. I have two questions and I will ask them one by one. Mikael and Fredrik, you said that the main reason for the margin improvement in Q3 was the price increases and higher volumes. Yet, when I look at the margin development in the quarter sequentially or year-on-year, I come to the conclusion that much of this improvement was driven by OPEX costs, such as R&D and SG&A, and not that much by the improvement in gross margin. And I would expect that the pricing and volumes would translate more into the strength in the gross margin. I would just appreciate your comment on that and what we should expect going forward.

Fredrik Westin: Yes, sure. First of all, what we are seeing is that we have now the balance in place related to raw materials. When it comes to the other inflationary pressures on labour, logistics and utilities, we have not come as far in those negotiations. That is one of the reasons why you do not see the full effect on the price negotiations on the gross margin line because there is still some outstanding work to be done on the other three components.

Then on the FX part, that hits, to a much larger extent, on the gross profit line than it does on the cost below. It is actually positive on the cost below gross profit. It is a significantly larger FX hit when you look at the gross margin. I think you need to consider that to understand maybe the operational performance better.

And then maybe lastly, there is still a lot of inefficiency due to the call-off volatility. The volatility is improving but it is still far from levels that we had pre COVID. And, for instance, premium freight is still also a cost burden to us. It is not as bad as it was in the first quarter or even the second, but it is still a headwind for us that is also impacting the gross margin.

Agnieszka Vilela: Okay, perfect. Fair point. And then my last question is about your referring to the 90% of the negotiated contracts being now concluded. The contracts that you negotiate, are they all contracts that you have or is it just the proportion of the outstanding contracts?

Fredrik Westin: I do not understand.

Agnieszka Vilela: Yes, I can say like that maybe, you have total contracts with your customers. Are you addressing all the contracts that you have with the price negotiations or are you just choosing some of the contracts to address?

Fredrik Westin: No, it is by customer. We typically have then an agreement by customer. It might be sometimes by customer region. But the 90% indicates that it covers all contracts that we have.

Agnieszka Vilela: All contracts. Okay, perfect. And then maybe a short follow-up on that. When we look at Q3, how much of your sales was based on the negotiated prices? Was it already 90% or was it a smaller proportion?

Fredrik Westin: It was less because there were contracts that were adjusted during the quarter and not all of those had retroactivity in them.

Agnieszka Vilela: Perfect. Thank you.

Philipp Konig (Goldman Sachs): Thanks also for taking my question. My first question is just coming back to the raw materials, you are guiding for around 5% for this year. If I look at it year-to-date, we are running at around 5% and it was around 4% in the third quarter. Is it fair to say that this is maybe a bit of a conservative assumption, given that Q4 should also see a bit of an improvement sequentially? And when do you see a potential rollover? I think in the first quarter of this year, you had the majority of your steel contracts that you renegotiated. Would these be renegotiated again in the first quarter of next year? That is my first question.

Fredrik Westin: Yes, we are saying up to 5 percentage points. And the reason for that is that, yes, we do see that, for instance, steel or other non-ferrous metals are coming down and they should also have a positive effect already in the fourth quarter. However, that is offset by yarn and resin, which has a different cost development for us. And as we have said many times before, we have the six to nine months' time lag between spot price development and when the cost comes into our P&L. And that still holds truth. So we need to see whether the indices develop it going forward and then what that implies for next year.

But I think it is also important to remember that even though we have seen the raw material cost come down, or prices come down, they are still at significantly higher levels than they were pre COVID.

Philipp Konig: Thank you. And my second question is just connected to the pricing on that. You moved up to 50% from 20% on the raw materials. Does that then also include the six to nine months' time lag in line with how it hits your P&L, or is it really pretty different across contracts?

Fredrik Westin: There is a range on the contracts as well. And what we are striving for is to have the right setup between of how the top line is impacted versus how our cost base is impacted. But as Mikael said before, it is rather complex structures when you look at how the different contracts are set up by customer and then also the adjustment cycles off that. But our ambition is that we have a better balance between both cost and the top line development.

Philipp Konig: Thank you.

Fredrik Westin: Thank you.

Emmanuel Rosner (Deutsche Bank Securities): Thank you very much. It is good to see that you are having productive negotiations around price recoveries for energy, freight, labour. When would you expect the timing of these negotiations to conclude? And would the benefit be seen this year or is it something that would be incremental for 2023?

Mikael Bratt: I think it is gradually coming on here as we move forward with negotiations. And as long as we live in an inflationary environment and we see continued cost pressure, it is, of course, an ongoing dialogue and discussion with our customer on how to pass this on. I would not say that we will be finished at a certain point. It all is connected to how the cost development will be when it comes to these external factors. But gradually seeing the effects from that.

Emmanuel Rosner: Understood. And then separately, in the implied fourth quarter margin outlook, you mentioned some typical seasonality and timing benefit in there. Would you be more comfortable thinking about your second half 2022 margin as a good run rate, to start thinking about building expectations for next year? Is that a cleaner number in terms of where you think your business is operating on an underlying basis?

Fredrik Westin: I think, first of all, the good thing here is that we are moving in the right direction and building a momentum as we manage through this difficult external landscape. And when you talk about run rates here, I think what we are showing here is that we have a good improvement on the underlying run rate, but we still have a lot of external factors heading in the wrong direction. It is still a headwind for us and will probably continue to be. And we have mentioned them earlier here around overall inflationary pressure. We have the currency situation volatility that we still see, and far from normalised there. And we have the component and labour shortages in general for the industry.

With too many moving pieces on the outside, I think it is difficult to be too firm here. But despite all this, I think we are showing that our own activities is really giving results. And I am happy to see that and I am feeling that we are well set up to continue to deal with the external environment here.

Emmanuel Rosner: Okay. Great. Thank you.

Rod Lache (Wolfe Research): Hello. I wanted to ask about the new contracts. If you do see direct material declines from here or commodity declines from here, can you maybe just give us a little bit of colour on how much of that gets retained? I believe that 40% of your material exposure is steel, which is obviously down a lot, but now you have index agreements on some of your contracts.

And then secondly, regarding the non-raw-material negotiations, so labour, logistics and utilities, could you give us a sense of what the value at stake is or what you are targeting in terms of recovery in that category?

Fredrik Westin: Yes, if I start with the raw material part, as we said a couple of times, there are different setups now with different customers and they follow both different indices and different renewal cycles. Our target is really that we have a balance between our cost side and on our customer side that does not have a significant impact on our margin going forward, but that we have a good balance between price and cost. Also, not to forget, we are indicating that we have closes on materials on about half the portfolio, not on more than that. The other half is still being negotiated and does not follow any type of indexation or close setup.

On the non-raw material, it is a significantly smaller part, how it has burdened our cost structure so far. On utilities, as we said here, it is around 1% of our cost base, and then we expect for this year to have maybe a 10 basis point increase on utilities. Whereas freight and labour are significantly stronger headwinds that we are facing. So the focus is really now for us to also have fact-based discussions with our customers and to be able to get the offset also for these cost types.

Rod Lache: Okay, great. And just lastly, can you maybe just give us an update on where you stand on the digitisation and automation initiatives and what you are looking at in terms of implementing that over the near term?

Mikael Bratt: I think we hold on to what we call the strategic roadmaps where digitalisation and optimisation is a part of. And I think that is very important to do that, even though we have a lot of challenges short term in the market, and we are progressing according to plan there. And that, of course, is also what is helping us gradually each quarter.

Rod Lache: Okay. Thank you.

Hampus Engellau (Handelsbanken): Thank you very much. I wanted to hear you guys on any activity in Europe. I had some conversations with other sub suppliers to the auto industry saying that there has been cancellations from OEMs. And part of that could be that they are now seeing better component availability, which means that they are slightly normalising their inventory levels. What is your view on that and have you experienced similar in your daily basis? That is my only question. Thanks.

Mikael Bratt: As we said before here, we have seen improvements when it comes to the volatility. But I would say it is still an issue and far from normalised, so it is ongoing. Of course, the volumes also have stabilised and improved on an absolute level compared to the previous quarters. We are moving in the right direction, but it is still far from normalised here. And it is clearly so that, yes, the semiconductor availability has improved but we still see differences between the different customers here. Some is almost gone, it is not the topic, while others still are facing some challenges there. It depends on the OEM still.

Hampus Engellau: Fair enough. Thanks.

Mikael Bratt: Thanks.

Vijay Rakesh (Mizuho Securities): Yes. Hi guys. Just to beat a dead horse again. On the pricing side, just wondering, as you look at your price adjustments, some are tied to indices and on a rolling basis. But are you using 2019, 2020 as a base for some of this price increases or are they more tied to where pricing is now, which means as pricing starts to come down, it could impact your future pricing? Can you talk to what is the starting point? What is the base pricing you are using?

Fredrik Westin: Yes, it is a good point. Of course, if you are not on a set-up like that and then you have to jump onto an index, you need to make sure that you get the right price compensation. That is what we have been extremely focused on. For us, it has been really about getting the right height on these adjustments to compensate for, basically, the cost evolution that we had to absorb for a period of time. And that is been our prime focus and as we have closed out on 90% plus of these agreements, I think we can also then say that we have gotten the right height as we would have expected. Otherwise, we would not have closed them out.

Vijay Rakesh: Got it. And then as you look at 2023, given that pricing might come down, but still they could be fairly elevated, you would expect still that to be a fairly good tailwind into 2023 as well, right?

Fredrik Westin: I think it is too early to tell, but the way that the industry looks right now, it would indicate that the cost would come down. And then that would also then lead to an adjustment on the pricing side, or vice versa. And then really, our ambition is that we see have a better balance between the cost and the pricing development. And also, that this is reflected in a reasonable amount of time and that that reduces our risk profile as a company. That has been our main objective here.

Vijay Rakesh: Got it. Last question. On the inventory side, when you look at your OEM customers and the channel, can you talk to how inventory levels are improving? Or if they are not, either sequentially or year-on-year, if you can give us some colour? That is it. Thanks a lot.

Fredrik Westin: Actually, the main problem for us at the moment is more on the raw material side, so more on the incoming inventory levels. And that is where we have the larger problems, but due to still rather distressed supply chains and then also longer lead times. So that has been the larger issue for us. Then, of course, also the call-off volatility causes inefficiencies on the finished goods side. But that is not a large problem year-over-year. That was actually even worse last year than this year.

Vijay Rakesh: Got it. Thank you.

Fredrik Westin: I think we are out of time here, so I think we should close the call.

Mikael Bratt: Before we end today's call, I would like to say that we are continuing to build resilience and strength in turbulent times, relying on our strong company culture. Our actions are creating both short-term and long-term improvements, and we believe these actions will enable us to build an even stronger position, despite the challenging macro environment. We remain agile and prepared for more adverse market developments, should that be necessary. Autoliv continues to focus on our mission of saving more lives, which is our most important direct contribution to a sustainable society.

Our fourth quarter earnings call is scheduled for Friday, 27th January 2023. 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]