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NKT.CO - Q2 2024 Nkt A/S Earnings Call

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PRESENTATION

Claes Westerlind *- Nkt A/S - President, Chief Executive Officer, Member of the Executive Management Team*

Thank you. Good morning to everyone, and thank you for joining us on the call today. My name is Claes Westerlind, I'm the CEO, and I will have the privilege of presenting NKT's results for the second quarter of 24 due today. Next to myself, I also have our esteemed CFO, Line Fandrup, who, later on in the call, will take an in-depth look at our financial performance in Q2 and also throughout the first six months of the year.

Before we go into the presentation, I want to draw your attention to the regular disclaimer that both the presentation for myself and Line, together with this material that it's containing forward-looking statements. And with that, turning now to our key messages for the quarter.

Overall, we recognized strong operational and financial results in Q2 with continued double-digit growth in revenue and operational EBITDA for the seventh consecutive quarter, driven by positive contributions from all three business lines. We delivered organic revenue growth of 29% versus Q2 last year, increased earnings from solutions and applications led to an operational EBITDA of EUR86 million in the second quarter, which is equivalent to a margin of 14.2%.

Profitability in absolute terms and margins were both quarterly records for us and were 1.8 percentage points higher than the 12.4% that we delivered in Q2 last year. Supported by a number of relatively small orders, including variation orders to existing projects, our high-voltage order backlog remained at a high level of EUR11.3 billion at the end of the second quarter.

Free cash flow was EUR398 million in Q2 this year, which was driven by a higher earnings contribution as well as a favorable development in working capital and solutions. Excluding acquisitions and divestments, free cash flow in the second quarter was a very decent EUR542 million.

On top of this strong financial performance, the second quarter was one of strategic progress for us as well. Photonics was successfully divested during the second quarter, marking the final step on our growth journey towards becoming a focused power cable solutions company.

Furthermore, we also announced the acquisition of SolidAl, which immediately enhances our ability to serve power transmission and distribution operators with end-to-end grid solutions. Both transactions have strengthened NKT's market-leading position across voltage levels and have the company well positioned for the future.

Turning now to NKT's financial performance in the second quarter and the first half of this year. Double-digit growth, both in revenue and EBITDA was primarily driven by expanded capacity and solutions and a record quarter in applications. Revenues increased to EUR605 million in Q2 and EUR1.1 billion throughout the first six months, corresponding to an organic growth of 29% and 28%, respectively. This was in line with the trajectory that we have demonstrated over the preceding six quarters and that we continue to be on as a company.

In solutions, execution of our commercial products was overall satisfactory, which led to 33% growth in revenue and 60% growth in operational EBITDA. The applications business line continued to benefit from positive sentiment in the power distribution grid segment and various efficiency initiatives implemented in the recent years across our production sites.

The result was an operational EBITDA of EUR21 million, a quarterly record for applications and also equal to a margin of 11.8%. And last but not least, organic revenue growth in service & accessories was 90% due to an increased activity in the service business, partially offset by slightly lower revenue in accessories.

Despite higher revenue, the operational EBITDA margin decreased to an unsatisfactory level of 7.1% in the second quarter. Profitability was impacted by an increased cost base, reflecting higher employee headcount as well as work related to one legacy service agreement, which was executed at an unusually low margin.

Work related to this service agreement was successfully and basically completed during the second quarter. And as of today, no additional scope has been identified within the same agreement for the immediate future. Now diving deeper into each business line, starting with the solutions business line.

Revenue increased to EUR379 million in the second quarter from EUR285 million in the same quarter last year, reflecting an overall satisfactory execution as well as increased capacity and capabilities. Throughout the quarter, we continued to progress on several projects through various stages of execution, including Baltic Power, Borwin 5, Champlain, Dogger Bank, Draugen, East Anglia 3, Hornsea 3, SuedLink and SuedOstLink.

Overall, the loading situation in solutions remains high, continue to place elevated demands on the organization. Execution remains a key priority for us, both in solutions, but also for NKT as a whole going forward.

Organic revenue growth was 33% for the business line and operational EBITDA of EUR67 million increased 60% compared to Q2 in 2023. This was equal to more than of 17.7%, which clearly was satisfactory. Margins will continue to fluctuate as you're well aware from quarter-to-quarter depending on both our ability to execute, but also the underlying product mix that we had in both production and also in installation.

In Karlskrona, the approximately EUR1 billion investment program, which was launched in May last year, continued to progress throughout the second quarter, foundation work advanced according to plan, which enabled a successful start of the tower construction at the end of July earlier this year and the summer. And as a matter of Koheras, I can tell you that as of yesterday morning, we are up to about 20 meters in height of the tower. So that's good to see.

We also announced the technical specification of our second cable-laying vessel, NKT Eleonora, which will be equipped with three turntables, equivalent to 23,000 tonnes of cable-laying capacity and is set for delivery in '27.

Executing on the investment program continues to have the highest priority, both for myself, for Line, but also the organization as a whole, which includes managing risks and opportunities that have occurred and materialized, but also will continue to arise. The EUR100 million investment program in Cologne also continued progress throughout the second quarter with procurement activities currently ongoing.

Lastly, I would like to highlight that we successfully utilized our new Jet Plough on NKT Victoria in the second quarter, enabling reliable simultaneous cable-laying and burial operations during the execution of Borwin 5. This was an important milestone for us, and it's also another testament to our ability to successfully execute investments in the field of offshore installation, which is a vital part of our turnkey solutions business.

Turning now to the high-voltage market through the first six months of this year. Activity across our addressable market continued at a high level throughout the second quarter. We estimate that the value of the projects awarded in our addressable high-voltage market exceeded EUR13 billion through the first half of the year. This primarily has consisted of products that were converted into firm orders after being previously allocated as long-term booking commitments in 2023 as well as new orders where the majority has been based on DC technology.

We continue to see an average addressable market above EUR10 billion per year, and this reaches from the period of '24 up until 2030 with this year already now exceeding the anticipated average. In the near-term, we continue to see a robust demand and limited supply additions that could threaten the favorable high-voltage market landscape. As new capacity is gradually introduced in the years to come by both, us, but also our peers, we see a more balanced market emerging towards the end of the decade.

With that being said, we also have enormous respect for, especially the HVDC technology and the difficulty associated with expanding production capacity, erecting a new tower, interacting with subsoil conditions for mother earth, constructing new factories -- new factory around the tower, training and staffing the factory with skilled labor and establishing a consistent manufacturing process that adheres to the highest standards for quality or just some of the challenges faced, both by us when we are expanding, but also expectedly by our peers.

And as a personal reflection from having a little bit more than 15 years in the business, I can also highlight cost overruns, delays on timing, quality issues and the difficulty of attracting, training and retaining critical human capital as potential obstacles that the industry as a whole faces in the year to come. But I also, at the same time, want to underline the importance of the fact that NKT has in the last couple of years since 2020 and the expansions, which we have conducted proved that we are able to deal with most of these challenges.

From a market perspective, we do see that additional capacity will no doubt enter the market, which we believe is also a confirmation of the robust long-term demand for the HVDC technology. However, the timing of when a structurally larger supply chain materializes remains highly uncertain at this stage. We will have to wait and see how announced capacity additions materialize in the years to come. And this is with reference to what I just said before.

In the meantime, we continue to see robust demand, supported by the ongoing electrification of society and transition to renewable energy. Over the longer term, we have less visibility admittedly, which, to some extent, will depend on the political ambitions also across key markets. From where we stand today, we see a more balanced market towards the end of the decade. However, the timing remains uncertain. And of course, we remain vigilant and also in close observation of how the situation develops.

Looking now how the order intake during the second quarter has impacted our backlog composition. We continue to benefit from the structural shift in the demand that has occurred in the recent years. From 2020 until June or the end of the second quarter this year, we have delivered a strong backlog growth, as is known to you all, exiting the second quarter with EUR11.3 billion in firmly booked orders.

And on top of this, I remind you that we have the tenant frame with three main projects and two projects with SSE that continue to be presented as booking commitments, which have a combined value of more than EUR2.5 billion. We currently expect these products to be called off and included in the backlog in late 2025 or potentially early 2026.

The high-voltage order backlog broken down by customer continues to be tilted towards European TSOs, which now constitutes more than 80% of the backlog with other types of customers being less than 20%. From an application perspective, interconnectors continue to be roughly 55% of the backlog with offshore wind making up approximately 40% and the balance representing power from on-shore contracts.

Overall, an order backlog of EUR11.3 billion provides a strong earnings visibility for the remainder of the decade, which also is a good situation for us because it allows us to focus our efforts firmly on execution over the years to come. But we also continue to be highly active in ongoing tenders, and we are focused on building backlog further with selected projects adhering to a couple of principles, including but not limited to optimizing our asset utilization that we don't compromise on the risk and reward balance. And last but not least, also that the products generate a fair margin that reflects the value that we bring to the customer as an example, technological or just from a turnkey perspective.

Switching gears now and turning our attention to applications, which delivered a record quarter in terms of revenue, operational EBITDA and margins in the second quarter. Revenue of EUR175 million represented organic growth of 3% compared to the same quarter last year, which was a high comparison period also due to price adjustments that were implemented at that time to offset inflationary pressure. This was primarily the result of continued positive developments in the power distribution segment, where volumes increased compared to the same quarter last year and prices remained stable.

In the construction exposed segment, which is building wires and also part of the 1 kV cables, revenues and volumes were maintained at a stable level compared to the same comparison period last year. However, we continue to see that the demand is subdued. Driven by higher revenue as well as continued positive effects from the specialization of production sites in recent years, operational EBITDA was EUR21 million, equivalent to, in my eyes, an impressive margin of 11.8%.

Going forward, the financial performance of our newly acquired asset in Portugal, SolidAl will positively impact the applications business line. Due to the timing of the acquisition, which was completed on June 21, SolidAl did not have a material impact on the revenue and EBITDA in the second quarter. We have commenced integration of the SolidAl organization. And as I've done before, I just want to repeat myself and extend a warm welcome to the more than 430 very skilled employees that have joined our family as of June.

Coming now to the service & accessories business line, which continued on a similar trajectory in Q2 from Q1. Revenue growth was again significant at 90% and was due to increased offshore repair activity within the service business, partly offset by lower revenues in the accessories business. Despite higher revenues, operational EBITDA decreased to EUR5 million in the second quarter versus almost EUR6 million in Q2 last year. This was equal to an unsatisfactory EBITDA margin of 7.1%.

Throughout the second quarter, a high level of offshore repair activity continued to be driven by work related to one legacy service agreement, which we have discussed before, and that was also executed at an unusually low profit margin. Work related to the service agreement was concluded physically in Q2 and no additional scope has been since identified.

Profitability was also negatively impacted by an increased cost base, which is a reflection of the fact that we are growing both in service and also accessories, where we need a significant number of [jointers] and a larger volume of accessories to execute on our projects in our backlog.

And with those words, ladies and gentlemen, I would like to hand the word over to Line.

Line Fandrup - *Nkt A/S - Chief Financial Officer*

Thank you, Claes. I'll now walk you through NKT's financial highlights, starting with the income statement. So if we turn the page, starting with the top line organic revenue growth, as Claes previously mentioned, it was 29% in the second quarter and 28% through the first six months of 2024. This was driven by contributions from all three business lines with satisfactory execution and expanded capacity and solutions driving the majority of the growth.

Higher revenue was converted into operational EBITDA of EUR86 million for the quarter, equal to an EBITDA margin of 14.2%. This was a 1.8 percentage point increase compared to Q2 2023 and broad operational EBITDA of EUR61 million through the first six months of the year.

During the second quarter, NKT recorded one-off items of EUR1 million, which reflects transaction costs associated with the acquisition of SolidAl that was successfully completed in June. Subtracting these and depreciation and amortization, which was at a similar level compared to Q2 2023, EBIT was EUR61 million in Q2 2024. This was an improvement of EUR25 million compared to Q2 2022.

In financial items, we had an income of EUR16 million in Q2. This was mainly due to our cash position that generated interest income. We also had positive contribution due to fluctuations in exchange rates in the financial items.

Now I'll turn to the tax line. Our effective tax was 3% in Q2 2024. This low level was mainly due to legislation in Germany, which was enacted in Q1 2024 that allows us to capitalize a higher amount of tax loss carry-forward. This brought our net result from continuing operations to EUR75 million in Q2 2024, which was an improvement of EUR40 million compared to last year. This quarter, we also successfully closed the divestment of NKT Photonics, which led to a net results in discontinued operations of EUR104 million.

Looking to the numbers of full-time employees, we see a growth of 718 compared to the same time last year. This is including the more than 430 SolidAl employees that Claes just mentioned as well as additional people to support the continued growth.

Now let's turn to the next slide on the cash flow. In the second quarter, NKT recorded strong cash flow from operating activities of EUR642 million compared to EUR321 million in Q2 2023. This was driven by a EUR585 million change in working capital that was primarily due to the timing of customer payments and solutions as well as the EUR27 million increase in EBITDA. This part was partially offset by a working capital increase in applications associated with the acquisition of SolidAl.

Investments in solutions and applications continue to step-up in the quarter, spend of EUR100 million CapEx in Q2, which was an increase compared to last year as well as the first quarter of this year. During the quarter, we also recorded a net cash outflow of EUR144 million related to the acquisition of SolidAl. In total, this led to positive free cash flow from continuing operations of EUR398 million in the second quarter and a EUR382 million through the first six months of 2024. Excluding acquisitions and divestments, free cash flow was EUR542 million in Q2 2024.

As Claes previously mentioned, we successfully completed the divestment of NKT Photonics in June for final enterprise value of EUR254 million. This led to a EUR248 million in cash flow from discontinued operation, which increased net cash flow to EUR641 million during the second quarter.

Let's now turn to the balance sheet highlights as of end of June. Working capital saw another significant decrease compared to the end of Q1 2024, ending the quarter at a negative EUR1.15 billion. As mentioned before, the phasing of customer payments and solutions were the main reasons for this decrease.

ROCE improved further and ended the quarter at 30% compared to 11% at the same time last year. This was driven by a decrease in capital employed where positive free cash flow and the proceeds from NKT Photonics resulted in a large decrease in net interest-bearing debt. Continued growth in EBIT also contributed to the further step up in [proceed].

With net interest-bearing debt at minus EUR1.3 billion, we have strengthened our financial position further in Q2. A robust financial position is required to fund the ongoing investments across the business as well as being the foundation for our continued growth in the journey ahead. Last but not least, the value of NKT's issued guarantees increased to EUR2.3 billion at the end of Q2 from EUR1.9 billion at the end of Q1.

Now turning to the financial outlook for 2024. On July 11, we released an updated guidance to reflect the strong financial performance through the first half of the year. This guidance is maintained. Revenue is expected to be between EUR2.33 billion and EUR2.43 billion versus the previous range of EUR2.21 billion to EUR2.36 billion and operational EBITDA is expected to be between EUR310 million and EUR345 million compared to the earlier communicated range of EUR285 million to EUR335 million.

The new ranges also reflect the expected contribution from SolidAl on revenue and EBITDA for the remainder of the year. I'll just go through the key assumptions related to these ranges as you see on the slide.

Point one is the satisfactory execution and development of high voltage investments and project without major disruptions. Point two is stable market conditions and applications. The third point is satisfactory offshore power cable repair work activity. Point four is the stable development of the global economy. Point five is the stable supply chain with limited disruptions and access to required labor materials and services. And the last point is a stable development in foreign currency and metal prices.

Before turning to the question-and-answer session, I'd like to reiterate the key messages for Q2 that Claes highlighted at the beginning of the call. So turning to this slide.

NKT delivered another quarter with strong organic growth of 29%, a result that we are satisfied with and reflects overall satisfactory execution on our order backlog in solutions. Higher revenue was converted into a record-high operational EBITDA of EUR86 million, equal to a margin of 14.2%.

Free cash flow was EUR398 million in the quarter, a result of higher earning contribution as well as favorable development in working capital in solutions. Our financial position has been strengthened further in Q2 and thus a conservative capital structure has to be maintained in order to execute on the investments ongoing across the business.

Lastly, within the divestment of Photonics and the acquisition of SolidAl, NKT recognized a quarter of strong strategic progress. A focused power cable company is what NKT has become, and we're well positioned to continue to capitalize on robust demand across voltage levels that continues to be driven by the ongoing electrification of society and the transition to renewable energy.

So with that, we are ready to take your questions.

QUESTIONS AND ANSWERS

Operator

Casper Blom, Danske Bank.

Casper Blom - *Danske Bank A/S - Analyst*

I have a couple of questions. I'll just take them one by one, so you don't have to write down too much. The first one goes to the, I would say, unallocated costs within EBITDA. You, of course, provide the EBITDAs for your three divisions and then there's a -- whether you call it unallocated or other group, which was minus EUR7 million here in the quarter. And to some extent, it kind of destroys a little bit the very strong margin development that you see on the divisional levels. Was there anything unusual in this minus EUR7 million? And could you sort of guide us a bit on what to expect going forward on this line?

Line Fandrup - *Nkt A/S - Chief Financial Officer*

Well understood. So I think I'll go a little bit back in history to also help understand this question. As you know, growing in a lot in Sweden currently also means a high exposure to the Swedish currency. And back in Q3 2023, we actually had some of the same questions around this, and it's the exact same explanation. So non-allocated cost is a reflection of two items, it's non-allocated group costs we have and then it's elimination of intercompany currency hedges.

And especially this latter part due to the Swedish entity having a functional Swedish Krona as currency, we do intercompany hedges. And that doesn't change, let's say, the Swedish -- it limits the exposure for the Swedish entity's currency exposure. But on a group level, since we are a euro company, we need to eliminate this.

When you reflect about the solution margins, you should think about the solution margins disregarding this non-allocated cost. I think some of you are asking the question whether you need to think about these eliminations should be added, subtracted from a solution business line result, and you should not. It's a different dynamic due to the changes in functional currencies. And now it's a bit technical, and we're also happy to explain later. But these are the two overarching elements. So when you see a currency development between the euro and the Swedish krona, we will see reflections of this on our financial results.

Casper Blom - *Danske Bank A/S - Analyst*

Well understood. Then my second question goes to Claes' comment about the high-voltage market, where if I heard you correctly, you said that you expected more of a balanced market or a balance in supply and demand towards the end of the decade. Correct me if I'm wrong, but I think that's a little bit changed from what you've said in the past, as I recall it, you've talked about still seeing higher demand than supply despite of capacity additions. So if you could just clarify if there is anything changed in the way you look at the market towards the end of the decade?

Claes Westerlind - *Nkt A/S - President, Chief Executive Officer, Member of the Executive Management Team*

To the question, it's a relevant one. I wouldn't say that something has dramatically changed. I think what we have done lately is also allowing ourselves to reflect well into the 2030s. Admittedly, this comes with a high uncertainty as well. You can look at projects, you can look at grid expansion plans. You can look at political ambitions and try to translate that down to the demand, and this is what we are doing.

At the same time, also we have our established peers, and then we have aspirational candidates to get into this market. They have announced plans in the past, but have also continued to announce plans. And of course, then it's about comparing and making the equation between these two. And when we do that, then we tend to see -- and again, with all the uncertainties that I just said now, we tend to see that there is a strong demand, where demand outperformed supply in the coming years. But then towards the end of the decade, being also 2030 and maybe even beyond, that's when we see it.

Depending on how many of the plans actually materialize on time and to the extent that they are put up, then we are looking at a more balanced demand-supply situation. So I think it's not anything to the contrary of maybe what we have seen before, but we have taken a longer perspective now, and that's why we are coming out with this or why I'm making this comment today.

Casper Blom - *Danske Bank A/S - Analyst*

Very relevant as this is an industry that's planning far ahead. Last question, probably to Line on the net working capital. Obviously, a strong development here in the quarter. If you could just elaborate on how to think about this for the remainder of the year. Will you start using some of these prepayments so that there would be, to some degree, a reversing situation in the second half of the year?

Line Fandrup - *Nkt A/S - Chief Financial Officer*

Understood also, it's a very favorable level. And you asked some of the same questions at the last quarter. What's really happening is, of course, the main impact from solutions business and the customer payments here. And then it's also a matter of the uptake in speed on our investment program. And you can see comparing Q1 to Q2 on our investments that we are picking up speed, and we should also, and that will actually continue for the rest of the year also. So expect an acceleration on CapEx here.

On net working capital, what will happen the rest of the year is very much, let's say, dependent on, of course, payments from customers, but certainly also awards. So there can be some dependencies on that we don't fully predict, of course.

And then I want to say for end 2024, I think you should reflect that is -- I would say this could be the level. We don't guide on this number. And then it can of course be changed quite much by single or just a few individual payments from customers that would move across the year, something like that, between 24% and 25%. So I had a little bit of cautiousness on that.

And then I just want to emphasize 1 point to be really clear about is, of course, it's a normal part of this business model that we receive upfront payments for actually planning and producing the cables. So when we are now building a backlog also for the second factory in Karlskrona, but there's still years to come before we actually will go into full production, we will see some of this very favorable position.

But in the moment we start producing those cables in a new factory, you will again see NKT's, let's say, steady-state position changing. And here, we would expect at current at least that it comes to a more normalized level, not so favorable as you've seen it currently. A little bit of a long explanation. I just want to help you out here in the future also.

Operator

Daniela Costa, Goldman Sachs.

Daniela Costa - *Goldman Sachs Group, Inc. - Analyst*

I have two questions. One is actually just a clarification of what you -- Line just mentioned going back on the free cash flow. Can you comment exactly sort of was it just one big contract, and was it a down payment or a milestone? Because when we look at like contract liabilities, they're going up substantially but the contract assets are not. Just to understand that. And then I'll ask the second one.

Line Fandrup - *Nkt A/S - Chief Financial Officer*

We don't comment exactly on, let's say, the type of customer, which customer, which contracts. So what all can say this is not a single thing. It's more elements within the solution business. But I would add to that, that we can have -- depending on the milestone payment, can have a very different size to a prepayment. So there are some very big single payments in our working capital from single customers that can move this picture, but not being specific here on Q2 what that was.

Daniela Costa - *Goldman Sachs Group, Inc. - Analyst*

And actually, following up on that just also from the prior question before my final one. Historically, the seasonality has always been very favorable towards Q4, that seems to have been the path of the industry, not just NKT. So given what we had this year and the CapEx plan, should we still expect that or now the volatility will be much more unpredictable going forward?

Line Fandrup - *Nkt A/S - Chief Financial Officer*

If you're talking about the free cash flow for the year, then you should expect an uptick in CapEx rest of the year. And really the pattern or the phasing of this combined with the phasing of possibly awards or larger milestone payments will determine, to a large extent how the free cash flow will end when we close the books of 2024. So there's some uncertainty that I cannot fully explain or divide for you here and now.

Daniela Costa - *Goldman Sachs Group, Inc. - Analyst*

And one question regarding, I think, Claes mentioned before on solutions that the margin will vary depending on the phasing of the contracts. If we look at the rest of '24 and '25, are we sort of materially more skewed towards installation or production, anything that we should keep in mind when we do that modeling?

Claes Westerlind - *Nkt A/S - President, Chief Executive Officer, Member of the Executive Management Team*

I can maybe start, Daniela, and then Line can complement if he wishes. But I think it's difficult to say. I think starting with the seasonality topic of solutions, it is true that, of course, more installation is conducted during the summer period. So that means that in the period from April to October, the weather is better than the rest of the year simply, and that is also reflected in, I think, the operational plans.

But of course, that's only one side of it. The other side of it is also the project mix and the revenue generation, both in the factory and installation. And there, it is difficult from the outside, of course, obviously, to expect which products will go into production and when we can have a quarter where five projects of higher margin are the primary drivers of our revenue when we can have another quarter where two of them were actually replaced with lower margin projects. And this can vary from quarter-to-quarter and therefore, it is devious. And as I said before, it's difficult to use a single quarter as a proxy for the next one.

Operator

(Operator Instructions) Akash Gupta, JPMorgan.

Akash Gupta - *JPMorgan Chase & Co. - Analyst*

I got a few as well, and I'll ask one at a time. And my first one is on solutions, plus, when I read your commentary on supply-demand, I wanted to ask how should we think about NKT adding further capacity on top of what has already been communicated? And when we look at your comments on more balanced supply-demand, do you see that the likelihood of you coming up with any new growth plan is low or will it be a function of your commercial win in the pipeline. So maybe if you can talk about how should we think about new capacity announcement on top of what has already been communicated.

Claes Westerlind - *Nkt A/S - President, Chief Executive Officer, Member of the Executive Management Team*

Just first with the caveat that notwithstanding just the resource situation or our own financial position in terms of further expansions, if we just put that to the side because I think, for example, the human capital situation, we have said before, it's also something that drives us to really focus at what we have on the table now. So -- but putting that aside and to reflect on your question more broadly, what I believe we have been fairly vocal about also previously is that we will continue to be disciplined when it comes to reflecting about adding capacity or investing and discipline, meaning that we have to have some level of certainty about the demand-supply balance and especially the demand coming into whatever capacity we are adding for a number of years before we would trigger such an expansion decision.

And I think with what I also shared with you here today with a more balanced supply-demand situation in towards the next decade, I think that comment is as relevant as ever. So we will not -- it's very unlikely that we would add capacity based on speculations or hopes and dreams, but rather, we will maintain the discipline that we have had in the past and just continue to reinforce the same.

Akash Gupta - *JPMorgan Chase & Co. - Analyst*

The second one I have is on your full year guidance. So when I look at your first half performance, EUR161 million EBITDA, and if we annualize it, given you may see recovery in margins in service and accessories, which might offset some of the lower half applications, we get to EUR232 million, and then if we add EUR10 million from SolidAl acquisition, we get to around top end of your new guidance.

So maybe you can talk about like what would happen for you to get to the bottom-end? Because when I look at your guidance, it's somehow less ambition and more like you're protecting your downside. So maybe if you can comment on that between first half and second half? And how do you come up with the lower end and top end of the range?

Line Fandrup - *Nkt A/S - Chief Financial Officer*

Akash, I'll go first and maybe Claes wants to comment. Let's start by saying that we don't feel that the guidance is unambitious. We're on a growth journey, and we have a very large project portfolio we're executing on. And I think you've also heard Claes earlier on the you need to be very risk agile working with these. So of course, in-built in our outlook for the year is this about being executing satisfactory on the projects and that's not a small undertaking. But we have done well in the first half, and we certainly plan to continue that.

I think another part, we've also spoken about and you still see to some degree here is that application is a fast business or a very dynamic business in that sense that we have a pretty good visibility on the months ahead of us. And then the longer you get out, the less we can be certain about customer buying patterns and these things.

It is changing a bit due to medium mortgage uptake, which has some different dimensions into the contracts. But there is, in the guided range, some space for actually having different dynamics in the second half. Then for part of -- for the first half year here, you saw us having a large repair job in our service business, how that eventually will pan-out for the second half is also still to be seen and then, of course, the assumptions on, let's say, more the general economic environment and access to resources embedded there. So we can certainly see NKT be in -- the straight of this range depending on how everything pans out.

Claes Westerlind - *Nkt A/S - President, Chief Executive Officer, Member of the Executive Management Team*

Yeah. And I would not add much to that, maybe just only that, of course, we do internally, we do our budgets and our expectations, and this is what we are basing the external guidance on together with recent performance. And in that, we also, of course, have more transparency over the product mix, which lies as the base for the buildup of the revenues and EBITDA quarter-to-quarter. So that also needs to be taken into account in addition to what Line said.

Akash Gupta - *JPMorgan Chase & Co. - Analyst*

And my final one is a housekeeping question on tax rate. You have been utilizing these tax losses carry forward. Can you give us a timeline on -- by when we should expect tax rate to return back to normal?

Line Fandrup - *Nkt A/S - Chief Financial Officer*

I wouldn't actually give you a timeline on that, Akash, and simply I would expect the multiple, let's say, decisions and things into that. But I can say, for the rest of the year, we do expect to continue to capitalize these tax losses and estimate for the year, and things can still change would be an effective tax rate around 15%. So that should help you here for 2024.

Operator

Lars Topholm, Carnegie.

Lars Topholm - *Carnegie - Analyst*

First, congrats with what I thought was a very solid quarter with nice margins in your two biggest division. I have a couple of questions. One is probably very boring, but you have a 2028 financial ambition, which was made before you decided to invest in expanding the factory in Cologne, before you decided to invest in expanding capacity in medium voltage and before you acquired SolidAl. And now, of course, I understand you didn't update this ambition today, but I wonder what are your thoughts about this? When is it an appropriate time to revisit those ambitions since the assumptions behind, of course, have changed dramatically?

Line Fandrup - *Nkt A/S - Chief Financial Officer*

And since this has been a returning question for the last couple of calls, we understand. And as also said earlier, we definitely both understand and are working on this. There are some building blocks in it. Of course, we want to really deep dive into as a company to make sure kind of how they turn out.

So once we further the current stance, but you're right, applications investment of EUR100 million, ROCE accretive, the same on Cologne, the SolidAl, and then, of course, also the awards of 2023 that came after we announced the medium-term ambitions are some of these building blocks. So we're working on this. I know we have said that before, but we are and we'll come back as soon as we're ready to communicate.

Lars Topholm - *Carnegie - Analyst*

And then second question to service and accessories. You mentioned cost inflation because you're staffing up. So I wonder if you can give some color on the increase in headcount and how we should translate that into when the business might tick up? Are you, for example, going to maintain the same revenue relative to headcount or how should I think about that?

Line Fandrup - *Nkt A/S - Chief Financial Officer*

I think I can start here with some of the building blocks and then maybe Claes wants to add in. So reflecting -- you're asking about the hires we're doing now to secure the growth of the future, that is if you're looking at our EBITDA margin, we would say, in 2024, 1 percentage point, we could have had a higher EBITDA margin if we didn't do that ramp-up. And this includes the services and accessories business.

What you're seeing in those two businesses and its different dynamics. One thing is accessory growth due to secure, we can actually make sure we have all the joints for the full backlog and execution of that. There's people in that. And there's also business development activities in other markets.

Then if you go to services, what we've been working on for the last year is, of course, also to secure we have enough joined us to actually do the joins and the cables, and that is, again, closely connected to the backlog. But it's also a geographical change in terms of some business development activity in other regions. So this is kind of the mix, but I would say on a single business line like services and accessories, it's a smaller part.

Claes Westerlind - *Nkt A/S - President, Chief Executive Officer, Member of the Executive Management Team*

I think you responded to it well. And maybe just to add, and I think we've had this discussion also in the past, Lars, that we want to underline the importance with us taking these decisions, hiring ahead of time. And it does become, on group level, meaningful. It is also, of course, meaningful on a business line level. And it's also connected, for example, joiners hiring them ahead of time. It takes time to train people. And it is connected sometimes to also uncertainties, which are outside of NKT's controls like permit, et cetera, when installation can actually take effect, which doesn't harm NKT's, let's say, the lifetime financial status of a product, but can indeed affect also a revenue within a single quarter, moving from one quarter to the next. So there are a number of moving parts here, but hiring of people for the growth is something which is present, especially in solutions in the custom perimeter, in accessories and also in the service perimeter.

Lars Topholm - *Carnegie - Analyst*

Then a final question, if I may, on the competitive landscape. And I just wonder if you can comment on to what extent you meeting Asian in general and Chinese in particular, the competitors, when you do tenders? And maybe if you can defend the answer, so you comment both tenders from TSOs and tenders from non-TSOs if there is a difference?

Claes Westerlind - *Nkt A/S - President, Chief Executive Officer, Member of the Executive Management Team*

It's a good question, Lars, and they're also highly relevant also considering the discussions in media in the last couple of days in adjacent areas. I would say, to try to answer it in a simple way, we have met Asian players in tenders, both in AC and DC for a couple of years actually. And sometimes they've also been successful. Sumitomo is one example in the Nemo project, which was awarded a couple of years ago and has been fully executed.

We have seen Chinese vendors being awarded on AC, lower voltages also on C cables a couple of years ago. But when you move into the higher segments, and I think to your point there, especially on the TSO side, it is uncommon that we are meeting credible Chinese players in those tenders. And what I say is that they may be a part of the qualification and tender process. But I think there is -- quality matters too much, and evaluation is not only based on price when it comes to TSOs that are using sophisticated procurement process, but most of them are actually doing these days.

For developers, it's a little bit more different depending on which developer it is. So there are some which are more actively looking into Asian vendors. But in general, we have not seen any massive presence, especially in HVDC of Chinese. So it is weighing, but not to a very major extent, if I answer on the Chinese part.

Operator

Xin Wang, Barclays.

Xin Wang - *Barclays Bank PLC - Analyst*

So my first one is on solutions. Could you maybe give some color on the subcontract revenue contribution in the quarter? How much of the year-on-year increase in EBITDA was driven by higher subcontract work?

Line Fandrup - *Nkt A/S - Chief Financial Officer*

We do understand it. We're not sharing the detail of that. I think what you've heard us say for the full year that it's a larger part of our revenue contribution in 2024 is subcontracted revenue, and it's higher than normal now, and this will normalize, you can say, in 2025. Therefore, we tried to help on kind of how to reflect about that. So not sharing the quarterly details and exact numbers here.

Xin Wang - *Barclays Bank PLC - Analyst*

Yeah. No worries. And also, on the upgrade on NKT Victoria, can you maybe let us know how much you spent on that? How should we think about the installation capacity expansion out of this upgrade. I think you previously said your manufacturing and installation capacity are roughly balanced. Is this upgrade and the effective capacity with no new manufacturing capacity being ended?

Claes Westerlind - *Nkt A/S - President, Chief Executive Officer, Member of the Executive Management Team*

I was thinking to myself how to answer it. I think if we start with -- maybe with the easy question, then how much money did we spend on that, I think on Victoria specifically, this was about minor redesigns and especially reclassification of her in terms of cable-laying capacity. So in that regard, you should think about, I don't know, say insignificant CapEx is maybe the wrong word, but it's very, very low spending on this.

When it comes to the wider update we have done in the recent years of the installation, like the NKT Jet Plough that I also talked about earlier in the presentation that has proven successful also in the field during the second quarter, in the context of factory expansion, it's also minor in terms of CapEx.

Now to your question around the balance between cable-laying and factory, we stand by our earlier comment and the re-rating of Victoria's cable-laying capacity is positive, I would argue, for projects where we can hopefully do longer simultaneous laying without having to go back, but it doesn't change anything from a major perspective. We are not gaining 150 days per year or so with this one. But there can be local upside in some projects with the fact that you can carry more cable and conduct longer-laying runs, but the significant addition, of course, comes with NKT Eleonora.

Xin Wang - *Barclays Bank PLC - Analyst*

Last question on applications. In the assumptions you made for your financial outlook, number two, you have stable market conditions and implications, which has not changed from Q1. Do you think this is overly conservative given you have made EUR100 million CapEx decision in April and then another EUR50 million on SolidAl? What will be the justification for this CapEx decisions if your market outlook remains stable?

Claes Westerlind - *Nkt A/S - President, Chief Executive Officer, Member of the Executive Management Team*

Yeah. I mean we can both comment on it, Line. I think that our intention with that statement is that it remains stable on a very good level that we are seeing. So this is a healthy level when we look at the market conditions for applications for the moment, especially in the power distribution grid segment, which covers medium voltage and also part of our 1 kV portfolio. And our intention is there but that doesn't significantly deteriorate or change, and I think such an assumption is -- I wouldn't say, is conservative.

Line Fandrup - *Nkt A/S - Chief Financial Officer*

And I would just add that when we took the investment decision on application, it was actually early in 2024. So there you can reflect that the business case where we assessed this, what is the value contribution to application and can see as a whole and our communication that this is accretive to our ambition of a ROCE above 20%, that was based on those markets. I do think you also reckon by the numbers that we have had a very good one here in the first half. So just to shed some light on what's the underlying assumptions of those choices.

Operator

Lucas Ferhani, Jefferies.

Lucas Ferhani - *Jefferies Financial Group Inc. - Analyst*

I have two, but I'll do them one by one. So firstly, on solutions, I think you're starting to hit tougher comps. Can you remind us on the timing of the capacity increase that has driven kind of the growth? And my point is to have an idea of kind of what kind of organic growth we can expect in H2?

And also, on growth in solutions, you're not providing necessarily subcontracted revenues, but can you give us an update on Champlain Hudson and how that project is going? Where is it in terms of completion? And should that be done kind of this year, next year? When do you see that ending because obviously, that will lead to some of those subcontracting revenues coming down?

Claes Westerlind - *Nkt A/S - President, Chief Executive Officer, Member of the Executive Management Team*

Starting on the investments. It's a good question. I'm happy to remind you, we did investment announcement in 2020 and also '22, respectively, for both Cologne and Karlskrona, and these investments are as of second half of last year completed from a machine perspective. And this is also the organic growth that we are seeing being reflected in recent quarters, so also under Q2. And so I think what you can expect going forward now is more modest organic growth as we have also said previously that as the investments are being completed end of last year, then we will see an uptake this year. But then in '25 and '26 in solutions space, it's going to be more modest, driven by that no new machines or the machine hours to stay constant over these two years.

Apart from that, you also had the impact, as was asked earlier and also now by you on the subcontracted revenues, which, of course, goes up and down, but they are at an unusually high level now due to the Champlain project and without going in and commenting on specifics in Champlain, the product, as we announced when we were awarded, is due to be completed in 2026.

But I think we have also made comments earlier that this year is a high year for subcontracting, and then it's going to fade down towards the provisional acceptance, which is going to take place in 2026, if all goes well, of course.

Lucas Ferhani - *Jefferies Financial Group Inc. - Analyst*

Just a quick follow-up on that. When you look at 2025, then you have, I think, a better view on the projects, the mix you're going to have and some of those subcontracted revenue. Do you still see, when you take all of that into consideration, some modest organic growth achievable, the solutions level in 2025?

Claes Westerlind - *Nkt A/S - President, Chief Executive Officer, Member of the Executive Management Team*

I understand the question. And I think I will leave it I think with the earlier comments we have given also at the beginning of this year, we tried to give a little bit of transparency. But we are yet to give out the actual revenue guidance and also EBITDA guidance for next year.

Lucas Ferhani - *Jefferies Financial Group Inc. - Analyst*

And the second one was on margin. With the comments that you made also on kind of installation activity during the summer and quite high utilization of the vessel, should we kind of take that maybe H2, see some normalization or maybe slightly lower margin sequentially with that seasonality. And similarly, on the services margin, is that legacy contract kind of now done and should we expect a slight kind of increased jump in the margin closer to what that business kind of was able to deliver previously?

Claes Westerlind - *Nkt A/S - President, Chief Executive Officer, Member of the Executive Management Team*

I will intend to start there. If I take the easy question first on service, what we have said previously is that the profitability is and has been suffering from this legacy repair. So of course, logically to that when the repair falls away from a P&L impact perspective, then the relative margins will improve.

If I go to the solutions one, it is a difficult question, and we are not guiding on business lines or individual quarters exactly what will happen with the profitability. And the profitability will be a mix of several things, as I said earlier, project mix, asset utilization, of course, impacted by installation amount of subcontracted scope also quarter-by-quarter. And these things will vary.

But all other things equal, of course, then if installation is lowering activity during a certain period, then yeah, this would have an impact, of course, or could have an impact both on revenue and profitability. But it's more complex than that. So I wouldn't use just our seasonality comments as a proxy to try to project the profitability has to go down if that would potentially be too simple.

Operator

Dear speakers, there are no further questions for today. I would now like to hand the conference over to Claes Westerlind for any closing remarks.

Claes Westerlind - *Nkt A/S - President, Chief Executive Officer, Member of the Executive Management Team*

Yeah. Thank you. And we appreciate everybody that's called in. And as -- I hope you can hear from the tone of our voice, we are, of course, proud of what NKT has achieved in the second quarter, and the credit goes to the people that have worked so hard to make this possible.

But we also stay humble and vigilant going forward. It is the product business, and we have to -- we can never let our guard down. So with those words, we look forward to hopefully meet many of you in the upcoming road shows, and we wish you a good weekend when it comes.