NKT

Q3 Earnings Call

Wednesday, 16th November 2022

Business Overview

Alexander Kara

CEO, NKT A/S

Key messages Q3 2022

Yes, good morning everybody, thanks for joining the call where we present our Q3 result. I have here with me in the room my CFO, Line Andrea Fandarup, and let's go to the key message of our Q3 results.

Overall, I would consider the results as satisfactory and we gave some qualitative indication about our Q3 results at our Capital Markets Day, which we hosted on 22nd September. As such, maybe not too many surprises in the Q3 result. But we may come back to that.

So overall we had an organic growth of 8% and the growth has also driven operational EBITDA. Based on the first nine months and the outlook, we update our financial outlook and Line will come a little bit later to the details.

Our high-voltage order backlog is still very high at €4.5 billion and we've had some orders from onshore, AC onshore and variation orders on the fixed existing projects. We issued a green hybrid bond of €150 million to strengthen our financial position for further opportunities and to grow. We also held[?] our Capital Markets Day on 26th September where we also announced our updated strategy, what we call ReNew Boost, where we gave an upgrade of our mid-term guidance and outlined the way, how we want our plans to go forward.

I had opportunity last week to be in Sharm El Sheikh and to participate at the COP27 and several meetings, like Caring for Climate. And it's clear that NKT and our cable solutions can contribute to the green transition, enabling transporting power from offshore wind to shore for interconnectors and for [inaudible]. Not only that we contribute as NKT to Scope 1 and Scope 2 but also to Scope 3 reduction. I will come later back to this. It was a quite interesting event, the participation, and I think as I said, NKT and the cable industry can contribute to the decarbonisation of society, which is an important goal.

In NKT Photonics, we continue with the process of divestment and we are processing here as planned. And it should be concluded latest by Q1 next year.

Performance in Q3 2022

If we come to the Q3 performance, we grow in Solutions and with this, the underlying operational EBITDA. Last year we had – in the same quarter, we had a one-time impact of €20.7 million of insurance claim, which we settled, which of course we have not this year. And this had an impact on the numbers, but overall we improved.

The Application results I would consider as unsatisfactory. Even so we could increase this, but this was purely by price increases, in volume [inaudible] produced and cable [inaudible] were reduced. And the reason for that was the higher input costs, and we may come back later in the presentation.

In Service and Accessories, I'm satisfied with the revenues and the operational EBITDA. Service had a good quarter but also in Accessories, on the high voltage side, we improved.

So you see the number on the right and we have already communicated that.

Solutions – Q3 2022

If we come to Solutions, in the quarter we executed several projects and with this, we generated revenues and the growth of 10% and an improved EBITDA of €24 million. The Victoria was busy with several jobs, Shetland, Troll and Doggers[?], and there was good utilisation.

We have continued with expansion of our factory in Karlskrona and Cologne and we inaugurated our extrusion tower in Karlskrona on 27th October, and we plan now in November to produce the first cables with investment what we have done.

We also produced the first low-carbon copper cable, where we reduced the CO2 emission by 23,000 tonnes for Dogger Bank C, which is the largest offshore wind farm in the UK and the first on DC. This is an important step to reduce Scope 3, and we need to continue here on this journey to reduce the Scope 3. As you may be aware, CO2 emissions, 95% or more is from copper, aluminium and so on production. Only 5% or less is in Scope 1 or Scope 2 of NKT or of cable production. So very important step where we work with the entire supply chain from the mine with the rock[?] producer, Electrovaya [inaudible] with the customer, SSE, [inaudible] and any [inaudible] to make that happen. It's a big step for the team[?].

High-Voltage Market Development

If we look at high-voltage market, we have received various AC onshore and variation orders and we were selected as turnkey supplier for East Anglia Three, which is not yet in the backlog a firm order. We wait here for notice to proceed and until the customer's final investment decision, which is expected to be happen in Q1 next year.

We received, in October, the HVDC onshore power cable Hertel-New York, which is the Canadian part of the Champlain Hudson express power project, with an order value of approximately €90 million market price and then €80 million standard[?] metal price. This will come this quarter, Q4, to the backlog.

Overall, we look at the first nine months, €7 billion on orders have been awarded. Out of this, NKT had roughly €2.1 billion, or actually a little bit more than €2.1 billion if you take Champlain Hudson Express with around €1.4 billion, SuedOstLink 2nd System, so this [inaudible] €700[?] million, €2.1 billion. This is around 30% and this is approximately also the market share which we had in the past and which we intend to maintain going forward.

For the full year, we still see €8 billion on project awards and going forward also for next year and the year after, we see €7-8 billion, a strong market to be continued.

High-Voltage Order Backlog

We disclosed here how we execute the backlog 5% for the remaining part of the year, for Q4, and 25% for 2023, and 70% for 2024 and onwards. These are round numbers and again this is a backlog, this does not include East Anglia Three or Hertel and so on. And obviously I have read[?] this morning the first reports from the analysts[?].

So this is a round number, 25%. A strong backlog with €4.5 billion. A little bit down from Q2, €100 million.

Applications – Q3 2022

Applications, I said already a very unsatisfactory quarter, weak quarter, driven by increased input cost. Even we could increase prices but the volume in [inaudible] cables has been reduced. We worked a lot to improve that further and we have written also in our report that we see some improvement into Q4 but it's a dynamic market.

Just to give you one example, we have received, for example, at the end of the quarter a massive price increase from a supplier, effective the 1st of the next month. So then we can imagine, if you get such letters with three, four days' notice, you have practically no chance to update your prices towards your customers. So we work on – anyway, we're working on price increase towards customers and also see how we can improve the situation with our suppliers.

So, we see a decline in construction-related business, meaning building wire and 1kV, mainly copper, which is due to the downturn on the European economy. So we feel really the recession on this part of the business.

If you look at the medium voltage, the demand is high, driven by the electrification of the society, the decarbonisation and all of these actions, so that is positive.

Service & Accessories – Q3 2022

Looking at Service and Accessories, we had a good quarter for Service and Accessories. Both contributed on revenues and on earnings, and I'm also satisfied particularly here with the high-voltage accessories, that we could increase the revenues. So, a good development.

What is new and what we have seen here are more and more concerns from customer, is that they're concerned about their critical infrastructure, or if you're talking about interconnectors and – but also offshore wind. We have all been following the news of Nord Stream explosion and in fact, one of the explosions north-east of Bornholm in Denmark was less than one kilometre away from an interconnector between Sweden and Poland, which was at the time under maintenance. And customers are getting concerned about the critical infrastructure and this is something what the cable industry and the customer needs to take care, how can this more be secured in the future, going forward. That's some new development in the market.

So, good development and we continue with our activities to move Accessories from Cologne to Alingsås and we see here, as we said, good development.

With this, I hand over to Line and she will guide you a little bit more through the financials.

Financial Highlights

Line Andrea Fandarup

CFO, NKT A/S

Income Statement: Improved Revenue Driven By All Three Business Lines

Yes, thank you very much Alex. So, Alex covered well the quarter in terms of an organic growth of 8% and I can just say also for the year to date, it's corresponding to 9% growth, so we are tracking well here. All business lines are supporting this still, which is also good to see.

And operational EBITDA, important to note, this is the insurance claim from 2021, which is adding up on the €45 million from Q3. If you subtract that actually, you will have a good underlying operational performance and also an improvement on the margin here.

Having a look at EBITDA and also the net result of the quarter, you know the one-off cost from last year at the same time, so, since we don't have the same here, we have a good level on the EBITDA. And also the net result is quite up compared to last year.

We are still continuing to ramp up on the FTEs. We are driving the footprint changes continuously as we have announced, both for – we are coming to the end of the – not fully there but coming to the end of the application footprint moves[?] on the factories. And then from Cologne to Czech, we are also continuing that journey, meaning we ramp up at least to be ready at the receiving end and eventually at a later point, we ramp down.

Balance Sheet: Leverage Ratio Remained Below Targeted Level

So I think that was it on the income statement. If we then go to the balance sheet highlights, you will note that working capital, if you disregard the hedges, we are having some iteration compared to last quarter, and this is primarily due to a build-up on inventories in the Applications and in general, also securing that we have our raw material stocks, we're ready to produce. We also some phasing of milestone payments in the Solutions business.

And then on the contrary, we are seeing some accounts receivable improvements due to collection of debts in the Applications business.

If we go to the ROCE, you see across quarters that we are more or less stable around 3-4%. And it's not two months ago we had the Capital Markets Day, and then we also shared with you that the ambition here is to move up and beyond the double-digit or into the double-digit space. So you will see this gradually improving over years but it's of course very important that actually our expansions, our investments, come more online and they start contributing here with the earnings expected.

Cash flow was at a lower level, very much from the investments also. So we see our net interest-bearing debt increasing with a leverage of 0.6 times EBITDA. As Alex also mentioned, we issued the green hybrid securities, €150 million, more or less replacing the hybrid we had in place.

Cash Flow: Negative Free Cash Flow as Investment Programme Continued

So next to the cash flow statement highlights. The cash flow from operating activities was slightly negative as the earnings contribution was outweighed by the changes in working capital and the continued investment flow, which you see here in the year-to-date number, 144, compared to 123 rest of year. So we are closing out on the investment and the expansion in Cologne, we are continuing in Karlskrona, as you remember from Q2, with the new tower, the green [inaudible], now with the second extruder coming there. And you'll see more of the investments in that throughout 2023 also.

Financial Outlook with Continued Growth Expectations

If we go to the next slide, a recap on what we announced this morning. An update to our financial outlook for the year. On the revenue side, €1.4-1.45 billion. And on the operational EBITDA, we are removing the lower end and saying we expect to be within €140-155 million for the year[?].

Of course, [inaudible] things, as we have seen throughout the last three years at least, can happen, but this is very much with the underlying assumptions of the current business that we see, that we expect [inaudible].

Key Messages Q3 2022

Repeating the key messages, organic growth continues, so our expected rest of year, we have a good order backlog and we have also a good market share of the awards of this year. So we now have more transparency about the sharing of how much we expect to execute on the backlog in 2023 from the report[?].

The issuance of the green hybrid security and the launch of the updated ReNew Boost, including medium-term investments, and let me just repeat them here. Wwe expect to grow about 12% on average over the time horizon out to 2025. We expect to be in operational EBITDA of 14-16% and we expect to come in to an above 12% ROCE at the end of the period.

So, very much grabbing the opportunity of the green transition. So with that, turning into the Q&A session.

Q&A

Operator: Thank you. Dear participants, as a reminder, if you wish to ask a question, please press star one one on your telephone keypad and wait for your name to be announced. Please stand by while we compile the Q&A roster. This will take a few moments.

Now we're going to take the first question. And the first question comes from the line of Massimiliano Severi from Credit Suisse. Your line is open, please ask your question.

Massimiliano Severi (Credit Suisse): Yeah, hi, good morning, thank you for taking my question. I have two, one per division. The first one would be, the margins on Solutions this quarter were quite low despite full Victoria utilisation. I was wondering, is it just purely project phasing or are you seeing margins deteriorating also because of inflation and issues in passing higher inflation to customers in projects?

Alexander Kara: Yes, if it comes to the margin in Solutions, 12.8% or 12.9% is lower than the previous quarter. It's phasing of the projects. We still have some projects with lower margins in the backlog, which we need to execute. For example, Attica-Crete we are in installation phase. And, of course, most of the costs in Solutions we can hedge, but then we cannot cover all the costs. For example, steel cost for the Solutions which, also, the steel price has increased. But it's mainly phasing and then some other effects.

Massimiliano Severi: Okay, thank you. And my second question would be on the Application and the price-cost issues there. More or less, when can we expect normalisation in terms of time, given that you're phasing prices? And if you think that the 7-9% margin range that we talked about in the past can still stand once price-cost issues normalise in the division.

Alexander Kara: Yeah, regarding the cost, as I said, and as we wrote in the report, we see improvements. And obviously, we see the October numbers already. This gives us some confidence. But we see also a still extreme dynamic development of input costs. And I mentioned just before, we have received a letter from one supplier a few days before end of the month with a massive price increase from 1st of month the next month. So if we get such an increase, which has a not insignificant impact on the costs within five days effective, or four days, very short time, you have practically no chance to raise the price towards your customer.

This is one example and what we have behind us, I would say, or managed so far, is the first phase of price increases, but it's not excluded that we will see a second wave of input price increases triggered by energy prices, transportation, premium on metals, premium or cost increase on plastic[?] due to higher energy prices, and so on. So we see improvement for Q4. Is that stable? It's hard to say, difficult to say. There's very dynamic. So I would not lean out at this stage and say we're out of the woods.

And saying that 7-9%, I think that the market, the input price, needs to stabilise and then on that basis we can see where you end up. But it's a very dynamic situation, unfortunately.

Massimiliano Severi: Clear, thank you.

Operator: Thank you. Now we're going to take our next question. Please stand by.

And the next question comes from the line of Nancy Ni from Goldman Sachs. Your line is open, please ask your question.

Nancy Ni (Goldman Sachs): Hi, good morning and thanks for taking my question. I just wanted to follow on on Applications. You flagged sort of weakening European construction and the macro in general, so I just kind of wanted to hear your thoughts maybe going into 2023, if we see continued macro weakening, where you think Applications is headed.

Alexander Kara: Yes, I mean, we see a clear – a clear trough[?], I mean, impact on building wires and 1kV copper. So the demand is weakening substantially, so we will see here impact on revenues but also in output, consequently, on tonnes of cable produced and building wire and 1kV. So, it's – I do not expect that this will be soon over, the recession. I assume this will continue into 2023 but I'm also not an economist to predict here the future. But I doubt that it will be – that we will soon see a recovery. I think we need to live with the situation on lower demand for buildings. Yeah.

Nancy Ni: Got it, thank you.

Operator: Thank you. Now we're going to take our next question. Please stand by.

And the next question comes from the line of Claus Almer from Nordea. Your line is open, please ask your question.

Claus Almer (Nordea): Thank you. Also a few questions from my side. The first goes to this order intake you had in the quarter from onshore wind and also variation orders. How should we think about the margins on these orders? That will be the first question.

Alexander Kara: I mean, the margins typically, if we talk of offshore, normally the variation orders are having equal or better margins than the original margin of the project. In onshore, we see a trend towards better margins for projects which are coming in, but those are partly getting executed, let's say. A little far out, we have a quite good backlog in AC onshore so what we see increased improvement also in AC onshore and also driven by higher demand.

Claus Almer: Okay. And do you see, in general, more of these variation orders, when you get the order in the backlog and then as long as the project is making progress and you see more variation orders being added?

Alexander Kara: No, I would not say it's more. I mean, variation orders are – in offshore are driven mainly from installation, to changes on installation spread. That can vary sometimes from year to year but it's not that it's going substantially up or down. It depends also how much offshore installation work you have. I mean, if you have more offshore installation work, then also the likelihood that your variation orders is going up.

On onshore you have typically less variation orders on existing projects during installation. So it varies a little bit, it depends how much installation you have, Claus.

Claus Almer: Sure, okay. And then my next question goes to the whole production quality and efficiency within the Solutions division. Maybe can you give an update on how do you see this progressing, both from the existing lines but also the ramp up of capacity?

Alexander Kara: Yeah, I mean, the ramp up of capacity, I said we have more of a close[?] on revenues, as you can see in the numbers, and we inaugurated just now on 27th October the tower in Karlskrona. Before, it was not ready and we are starting now in November to produce the first cable in Karlskrona, and we are a little bit earlier in Cologne. So we actually have seen a rather slow start here and then a slight delay, to be honest. But these extrusion lines are also – even the suppliers deliver[?], produce several of those. It's not a machine that you press a button and then, boom, the cable comes out. So a lot of adjustments.

So the ramp-up will happen now gradually and we should see it then in full in 2023 from the expansion, meaning the expansion what we did – we've done a €150 million investment. The €90 million will come the year after.

Efficiency improvement, we work of course on efficiency improvement and we have moved one extruder from Cologne to Velké Meziříčí and obviously, during this move, you cannot produce cable, so you miss that volume from this extruder. This has now been completed, the installation of that extruder in Velké Meziříčí, and we are starting now to produce the first cables. Then we need to make type tests. Once these type tests are completed, we can start the production in Velké Meziříčí. That will happen in Q1 next year.

Then we have the shift again from AC to DC in Cologne. That's also ongoing, so it's a little bit a dynamic process, where we should see improvement next year mainly. Not too much this year.

Claus Almer: Sure. But so giving this new capacity being added, I know it's still early days but are you, let's say, satisfied by the – what you see so far?

Alexander Kara: Yeah, I'm satisfied and – I'm satisfied but I mean, if you – if you install new equipment, there's always some, let's say, hiccups. But it's normal. I mean, I have done also –

Claus Almer: Sure.

Alexander Kara: – [inaudible] in the past and we work through this with the supplier. Also, at the end we need to ensure that we deliver the right quality of cable, meaning the roundness, the [inaudible], preciseness. In that case, it's [inaudible] for two different extruders with different – we have different suppliers. So it's a lot of fine adjustments to ensure that the quality is at the level of what you want to achieve. Particularly if it comes to DC, it's very sensitive and you need to be in the limits of what you have – what is designed to have the performance.

Claus Almer: Okay. So it sounds like you are ready for 2023, so thanks Alex, that was all from me.

Alexander Kara: Yes, we are ready for 2023.

Operator: Thank you. Dear participants, as a reminder, if you wish to ask a question, please press star one on your telephone keypad. Now we're going to take our next question. And the next question comes from the line of Akash Gupta from JP Morgan. Your line is open, please ask your question.

Akash Gupta (JP Morgan): Yeah, hi, good morning everybody and thanks for your time. My first question is on offshore wind project awards. And here the question is more about decision making and speed of decision making in light of these windfall taxes prospect that we see both in the UK as well as in Europe. I mean, I think here in the UK we will have a provision Thursday whether we will see windfall taxes and what will be the level of windfall taxes threshold. I'm just wondering, like, are you having a dialogue with your customers in terms of could there be any potential delays in closing down orders or awarding firm orders based on what kind of surprises might come out in these announcements in coming weeks, which may change from time to time given the situation in both Europe and UK?

Alexander Kara: No, I mean, we don't see here any delays. I mean, we have East Anglia Three announced and we work also on other opportunities where we don't see any delays. But I mentioned in the beginning that I was at COP27 and one of the topics that was the permitting and the delays of the – or the duration of the project from start of development until completed. I was there on a session about Dogger Bank and it took ten years from start, then it was finally coming into service. This is too long and several participants in the COP27 mentioned that. The duration is too long and also, from the financing, certain parts are pretty complex. In this project, particularly, more than 30 banks were involved.

So this, the whole permitting needs to speed up in order to manage the large growth which the countries are committed to, to manage that. But to answer your question, we do not see any delay in our projects we have on hand or which we expect to become an order.

Akash Gupta: Thank you. And my second one is on the capacity situation for next year in Solutions business. So thanks for providing this chart on phasing of backlog, and I think here you say that roughly a quarter of backlog or around €1 billion in standard metal prices has already been secured for 2023. I'm just wondering how much more flexibility do you have in order to take orders for next year capacity – or next year production and installation, given it looks like you're already in very good shape from backlog standpoint at this point in the year?

Alexander Kara: Yeah, thanks for the question. We said 25%, €1 billion, that's from the backlog. What's not included is obvious, is [inaudible] or in and out orders, which contribute. And then we can also take some more orders, question is if there's something coming generate revenue next year. But we have still capacity to take some more orders, particularly on the AC offshore cable part.

But we have a good coverage so far.

Akash Gupta: Thank you. And my final one is on cash flow. I mean, if we look at first three quarters, I mean, cash flow has been negative but I guess that is not a major surprise. But looking for the rest of the year and especially in terms of milestone or down payments in projects, what sort of net debt level should we target for end of the year? Any ballpark range if you can give, that would be great.

Line Andrea Fandarup: I think the best way to give you is to have you look at Q4 historically, right, and you usually see an improved performance, and that's definitely also, let's say, how we work with the cash collection, milestones, everything and even more [inaudible] towards the end of the year. So I think that's the way to go about it, Akash.

Akash Gupta: Thank you.

Operator: Thank you. Now we're going to take our next question. Please stand by.

And the next question comes from the line of Massimiliano Severi from Credit Suisse. Your line is open, please ask your question.

Massimiliano Severi: Yeah, hi, thank you for taking the follow-up. Just a more general one. Where do you see and when do you see potentially the first 525kV submarine extruded orders coming up? Also, in the context of TenneT launching the tender in September for this technology.

Alexander Kara: Yes, as you say, actually, TenneT have a tender out for five offshore wind projects in the Netherlands. So most probably this will be the first – one of those will be the first offshore wind that we will see. It's an ongoing tender process and, yeah, we need to see when it will be awarded. There is some questions about environmental impact in the Netherlands, which is some concern, but if that has impact on the delay of these orders. But that we need to see that came[?] just recently, so it's too early to say.

Massimiliano Severi: And do you generally see also interest on the interconnection side or for now, it's mostly TenneT with this Dutch wind project for the 525kV technology?

Alexander Kara: No, there is also interconnectors in UK. Several under discussion, or tendering to be more precise, 525kV to Western Isles, which was originally 300kV DC has changed to 525kV. On East Coast of UK are several projects under discussion, 525 DC. So this will come. This will come also soon. I mean, soon, as in award, not necessarily in production and execution.

Massimiliano Severi: Yes, clear. Thank you.

Operator: Thank you. Dear participants, as a reminder, if you wish to ask a question, please star one one on your telephone keypad.

Dear speakers, there are no further questions. I would now like to hand the conference over to your main speaker today, Alexander Kara, for closing remarks.

Alexander Kara: Yes, okay. Thank you very much for your good questions and wish everybody a good day and talk to you soon. Bye bye.

[END OF TRANSCRIPT]