



NKT Q1 2022 Report

Wednesday, 18th May 2022

NKT

Alexander Kara

*President & CEO, NKT A/S***Welcome**

Thank you. Good morning, everybody, and thank you that you take the time to listen to our Q1 results. So today, we have here in the room who will present, it is Line Andrea Fandrup, the CFO, NKT, myself and Basil Garabet, the President and CEO of NKT Photonics.

Key messages Q1 2022

If we look at the key highlights from Q1 2022 from this quarter, the cable business has grown organically 7%, and here main contributor was applications with the record high quarterly revenues, which contributed substantially. The operational EBITDA has increased from 10.2% to 12%, which is a 1.8 percentage point increase.

On the development, on upgrades, on Karlskrona and Cologne, the high-voltage factories been growing according to plan and the investment will be completed this year by end of the year at the latest.

Also in Q1, we have an acquisition, a family-owned business, Ventcroft Ltd in the UK, where we produce fire-resistant power cables, which will help us to grow in this segment.

Photonics had grown 7% organic, and we divested at the LIOS sensing business. And now going forward, NKT Photonics to focus on the core business.

NKT Performance in Q1 2022*Positive performance driven by Applications*

If you look at the business performance in the first quarter, the Solutions despite that we have lower revenues of approximately €10 million, we had a good execution and efficiency initiatives, which contributed to the good result on the operational EBITDA.

Application had the strong quarter in terms of revenues and also on operational EBITDA, driven by a market, which is in favour of all products, what we have and we have grown in all countries with all products in all markets. I mentioned already acquisition, which help us to strengthen our position in the fire-resistant cable.

Service & Accessories' revenues and operational EBITDA was lower than last year the same quarter. And the last year, we had very high Q1, as you know. So the revenues went up from €296 million to €319 million, 7% and operational EBITDA from €30 million to €38 million, in round numbers, 10.2 to 12 percentage points.

Solutions – Q1 2022

If you look at Solutions, we have a little bit lower revenues than the same quarter before, €10 million. This was due to the mix of the production. However, the operational EBITDA income increased from 12.1% to 16.4 percentage point. We had a good execution on several projects, and they are listed here on the slide, Borwin 5, Dogger Bank A, where we had the first campaign online, Dogger Bank C, the Shetland project, but also the Ostwind 2.

The Karlskrona update and Cologne is progressing as planned. And I would like here also to mention even it is not related to Q1, we have started the first production of the SuedLink in Karlskrona just recently. NKT Victoria has a satisfactory deployment and was involved in several projects. Overall, a good quarter, a strong performance for Solutions.

High-voltage market development

Market activity remained high

If you look at the market, the market outlook is positive. When it comes to variation orders of existing projects and onshore projects in Q1, the total market was at around awards of €2 billion, mainly projects in Europe. And as we said in the Annual Report, the market for 2022, 2023 and 2024 year to come is around €7 billion to €8 billion.

I would like here also to mention yesterday it was announced in an offshore wind summit in Denmark with the presence of Ursula von der Leyen, and Olaf Scholz, the German Chancellor, that the four countries Germany, Belgium, Netherlands and Denmark plans to increase the installation of offshore wind to 150 gigawatts till 2050, which is tenfold in the North Sea. So that is a big growth, will be a further accelerator and good for the cable industry.

So the European Commission also has outlined that they want to be less dependent of the gas, Russian gas, and that we will also be positive for the cable market. You see here some projects on the recent orders which we have won.

High-voltage order backlog

The high-voltage order backlog was EUR 2.75bn at end-Q1 2022, down from EUR2.78bn at end-Q4 2021

If you look at the order backlog, in NKT it went slightly down from Q4 from €287 billion to €275 billion, but still very strong. And we work on several projects in offshore wind interconnector and also oil and gas. And you see here roughly the revenue distribution for the remaining part of the year, 20% and 80% onwards.

Applications – Q1 2022

If we come to Applications, Applications had a very good quarter. We increased sales in all the countries where we sell with all the products. And we increased organic growth by 32%. This is, of course, here also needs to be seen to relative weak Q1 last year. Nevertheless, 32% growth is a strong quarter. And also the operational EBITDA improved from 5.7% to 7.9% compared to last year.

Strong quarter, as I said, with all products in all countries, from low-voltage one kV to medium-voltage driven by the green agenda with upgrade of power grids and also with an increased number of electrical vehicles.

Service & Accessories – Q1 2022

If we look at Service & Accessories, the revenues were lower and also the earnings were lower compared to Q1. Q1 last year was very strong with several repairs. This year, we had one repair in Q1 at Kontiskan-2, which is a cable connection between Denmark and Sweden. And we had some temporary cost increase due to the transfer of high-voltage accessories from Germany, Cologne to Alingsås in Sweden.

We established a hub, the service hub in Gdynia, which will help us to serve the market in Poland but also in the Baltic with increased market outlook.

So overall, the sales in medium voltage and accessories has been up, whereas we have some decrease in the high-voltage part.

With this, I would hand over to Basil on the Photonics side.

NKT Photonics

Basil Garabet

President & CEO, NKT Photonics

NKT Photonics performance in Q1 2022

Record-high Q1 revenues for NKT Photonics

Good morning. Thank you, Alex. On the Photonics side, NKT Photonics again had another record quarter. That is seven in a row at the moment. The key developments in there is that we had a broad-based growth in three of our four markets and the revenues for Q1 increased by 10% organically over the same quarter in 2021.

2021 was actually a record quarter for us as well because that quarter increased by 26%. So this is an additional 10% overlap. So a good movement. The business is moving in the right direction and we are seeing some very positive call from the market.

Operational EBITDA was slightly down, mainly caused by write-downs to obsolete and slow-moving material. We also got affected with one-time costs for the strategic review that we are undergoing at the moment.

On order intake, as I mentioned, it has been a very positive market. The trend has continued in the quarter and we are up by 16% over the same quarter in 2021. In the same quarter, we also divested a non-core business. This is our LIOS sensing business and we have done that to fully focus on our core business, which is lasers.

Business development in Q1 2022

We move to the next slide in the business development side in Medical & Life Sciences. This segment continues delivering very strong revenue and growth order intake, especially on the ophthalmology side, where we are adding on a number of new projects and a number of new OEMs and it is a very positive move for us.

In the Industrial segment, we have continued the growth, especially from our hot rolled from our semiconductor customers into those large tool manufacturers in the industry, and that continues through the year with very positive results.

In Quantum & Nano Technology, we had a slight decrease but that does not really echo what is happening in the industry as the orders are coming in that much faster. So it is really a timing issue and we will continue that growth.

And finally, in Aerospace & Defence, we had exceptionally high growth again in this segment and we see the market due to various aspects of the geopolitical situation that we are increasing. So we are seeing favourable growth there.

And with that short presentation, I pass over to Line to go over the financials.

Financial Highlights

Line Andrea Fandrup

CFO, NKT

NKT Group: Improved revenue and operational EBITDA

Thank you, Basil. So on the NKT Group highlights here on income statement, summing up what Alex and Basil shared with you that across the two companies a 7% organic growth for the quarter and improved operational EBITDA margin compared to last year same quarter with a very strong performance in the applications business in the cables, where we almost doubled the operational EBITDA, so very sound financial performance.

The operational EBITDA also improving across the Group here. And if you look at the one-off items, just to note that this is related to the acquisition of the Ventcroft business and it is related to the divestment of the LIOS sensing business. So an EBITDA for the quarter of €45 million and a net result summing up to €15 million compared against the €2 million in the same quarter last year.

NKT Group: Higher debt level due to development in working capital

If we turn to the next slide, looking into the balance sheet highlights. And NKT Group will always come out of a very favourable working capital position at the end of the year, Q4 2021 as a comparison base. And then we build up inventories for the season. And in this year, the first quarter also reflects that the trade receivables was rising from increasing sales in the Applications business.

So you see here a development in working capital, where we end at a €66 million at the end of the quarter. Looking at the RoCE, here you also see a continued improvement to the level underlined and driven on the quarter very much from the cables business. But if we look across the quarters, going back in time, that we are developing positively on the RoCE here.

Leverage is at 0.7x due to an increasing debt level due to the working capital development and also continued investments in the businesses.

The last bullet on this slide, before we turn is that the €150 million hybrid security issued in 2018 has the first call date in September this year. We intend to call the security no later than this date.

NKT Group: Positive earnings contribution more than offset by working capital and investments development

Going through the cash flow statement highlights. The expected increase in the working capital outweighed the positive EBITDA development of the quarter, therefore, also leaving us at a lower level in cash flow from operating activities than compared to Q1 last year.

Cash flow from investing activities. Here, if you look at the CapEx, we are at a higher level compared to a quarter last year. We have a high level of activities relating to the expansion programmes in both Karlskrona and Cologne. And this is the reason for this development.

So overall, net cash flow for the quarter at minus €81 million compared to €60 million at the same quarter last year.

Financial outlook 2022

We maintained the outlook for the year for both companies, NKT Cables at around €1.35 billion to €1.45 billion on the revenue and an operational EBITDA margin of €130 million to €155 million for the full year.

For the Photonics, just a note here to restate the base comparison, excluding the years when you look at the organic growth. But we still maintain the outlook on the revenue for 12% to 17% and an operational EBITDA margin of 11% to 14% for the full year.

Key messages Q1 2022

So the key messages of the quarter is that it was a good quarter with 7% organic growth, a very strong performance from Applications and EBITDA margin that increased to 12%. We are well on track with our Cologne customer with factory expansions, and we complete this later this year.

Acquiring the Ventcroft business and strengthening the NKT cables positioned within fire-resistant power cable technology, and the team has entered well into the NKT cables and is fully integrated.

On Photonics, a 7% organic growth that you have to remember always that Q1 is a different development and a very strong Q4. That is the seasonality of the business. And then the divestment of the LIOS sensing business, now enabling Photonics to focus on its core business.

Save-the-date: Capital Markets Day 2022

And then on the last slide of this presentation before we go to the Q&A, we are very happy to invite institutional investors and financial analysts to Copenhagen on our Capital Markets Day on 22nd September this year. We will be delighted to tell you more about the business status and the expectations for the future of the cables division. So more details to come on that.

With that, I will turn over to the operator for handling our question-and-answer session.

Q&A

Casper Blom (Danske Bank): I have a couple of questions regarding the Applications business. First of all, the strong growth that you see here in the quarter, do you see any risk of this slowing down on the back of low-voltage cables being delivered into the buildings segment? I mean, one could probably build some sort of case that higher interest rates and very high cost on building materials could cause a slowdown in that segment. That would be my first question.

Alexander Kara: Yeah. I mean, the current situation is, as I mentioned, we see a strong market in all the countries, in all the product segments. Of course, we have increased inflation rate that is the risk. I mean, Applications business, low-voltage is a short cycle business of two, three months. And that could, of course, change but that is difficult to predict how it will develop. As of now, we see a strong market, and at the moment, we do not see any sign that the market would turn in a negative direction but that can happen.

Casper Blom: Okay. Have you made any specific assumptions in your guidance regarding this?

Alexander Kara: No specific assumption. I mean, Q1 was extraordinarily high with 32%. Do not expect that this will continue on that high levels[?]. That will be definitely not the case. But we expect for the time being that the market remains strong unless the market tell us something else.

Casper Blom: Okay. Fair enough. It is absolutely fair enough to expect the 30% growth going forward. But what about the 7.9% EBITDA margin? Is that a new stable level for the Applications business?

Alexander Kara: No. I mean, I said in one of the last calls that the 7-9% is in reach. We are now at 7.9% in this quarter. We continue to work on our optimisation in the factory on various efficiency initiatives, but also footprint. And in addition, we work also on the commercial side to increase prices. So whenever we can increase prices, we will do that and we will continue to do that. So we do expect to be in the 7-9%. And, yeah, we plan not to go down. Let us stay like this.

Casper Blom: Good to hear. Then just a question regarding Solutions. The very strong margin here in the quarter, I understand that it is partly affected by some release of risk and contingency provisions on projects that have been well executed. Can you put any more specific number on the positive tailwind from that side?

Line Andrea Fandrup: I think the performance here you see on the Solutions business for the quarter is driven by good execution. And then you are right, nothing specific on those projects also that the provision you have seen was, I think, last year in Q3 related to some projects we had released some of that. But underlying, a good performance on operations and then the release of part of this operation.

Casper Blom: Okay. So it is more the day-to-day operations that are doing well than it is just a one-off release of provisions?

Line Andrea Fandrup: Yeah. It is operational-driven performance [inaudible].

Claus Almer (Nordea): Also a few questions from my side. First of all, I would like to say congratulations with a strong Q1. The first question would be about the Champlain project. When do you expect an update on this possible order? That will be the first question.

Alexander Kara: Yeah. I mean, as you know, we are preferred supply, and as we speak, we are in the negotiation of the contract and we expect an update in the second half of the year.

Claus Almer: Second half, first. I mean, you have had ten years, I guess, to get all the details in place. So is there any major issues you have to solve? Or it is just things will take time?

Alexander Kara: No. We had 12 years' time to be more precise. Claus, we do not negotiate 12 years the contact details. No, but this is a big project. And besides cables, there are also other parties involved, where contracts needs to get finalised. I do not think they preferred supplier like Hitachi Energy. And this kind of a contract negotiation some times time and this is how it is.

Claus Almer: But you have assumed the guidance that you start-up production this year, right?

Alexander Kara: You can also start activities even if you have not signed the contract. If you make early works agreement with the customer, that is possible. You need not sign contracts. You can make intermediate agreements.

Claus Almer: Okay. So that part is not at risk as it seems today?

Alexander Kara: No.

Claus Almer: Good. Then my second question goes to the guidance. Given the very strong start of 2022, then the guidance for the cable activities at least now looks a bit on the cautious side. Is there any specific reason why you did not hike your guidance, or at least increased the lower end of the guidance range?

Alexander Kara: No, there is no reason. There is, of course, uncertainty with Ukraine and the whole situation with Ukraine and with material, with input costs, with inflation. So there is a lot of parameters, which could change. And it is just that we are cautious. And we want to see now how Q2 develops and then we will see what we are communicated. There is nothing specific except to be cautious because of these parameters, which I just mentioned.

Claus Almer: And there is none of these parameters in fact is actually turning against you so far. That is correctly understood, right?

Alexander Kara: No. Nothing would turn against us, no.

Claus Almer: Okay. Then the third question goes to Photonics and you, Basil. There was not a lot of words about the strategic review in the report. Should we read anything into this?

Basil Garabet: Hi Claus. No, not at all. I mean, the strategic review is ongoing. You saw that we have some one-time costs there. So you can deduce from that that it is, at least in going in the right direction. We also divested of LIOS, which was part of the strategic review. So it is in full fledge.

Claus Almer: Okay. And are you trying to prepare slides for the CMD 22nd September? Or do you expect not to be part of that?

Basil Garabet: That is a great question, Claus. I will answer it closer to September.

Max Yates (Credit Suisse): Just my first question is around Solutions. I mean, one of your competitors, Prysmian, had I think a much more difficult quarter of execution and profitability in their projects business, and talked about it largely being down to costs that were difficult to pass on to customers. So things like stainless steel for armouring, ship fuel for installation. And you look to have been largely immune from that. But I was just wondering, how do you manage those costs? Are you having and have you had negotiations with customers to try and price up your contracts versus original prices? And how do you see that evolving over the next few quarters? Do you envisage that will be a problem for your Solutions division? Maybe a bit of colour around that would be helpful.

Alexander Kara: Yeah. I mean, I do not communicate, of course, here on competitors. But I mean, there can, of course, be that at a quarter in Solutions can differ, like in Q4, we had a weak quarter, and this quarter we have a strong quarter. If it comes to cost increase, certain materials we can hedge. Others, we cannot hedge. And here, of course, we need to see how we deal this cost increase from field and/or project, which you have in the backlog, which are contractually binded.

So only what you can do is discuss with the customer and hope of their goodwill that are flexible that they share a little bit the pain, but that is not the contractual way. So in this, we are doing, but we talk to customers on that side.

And then overall, we do think it depends also on which quarter you are and whether you buy just metals. And then it could have a little bit more or less impact there. But so far, we could manage exposure on steel, which you cannot have stability well[?].

Max Yates: Okay. So, I mean, would you be willing to talk about how you have thought about your Solutions margin for the full year within the context of the overall guidance? I mean, I presume you used to have a 15-17% margin target for this division. We obviously were at 16.4% in Q1. I mean, you would need to fall quite substantially below this. So, I mean, is it fair to say that this will be the kind of best quarter of the year, and it will be very difficult to replicate? I am just struggling to square the comments of you have done a good job underlying, this is just the business performing and then how to think about margins for the rest of the year.

Alexander Kara: I mean, it is a good quarter with 16.4%, and you cannot necessarily expect that we will have the same margin quarter-on-quarter. So there can be variance as some.

Max Yates: Okay. Just the final question on the German corridors. So could you talk a little bit about when you expect to be producing these, whether we feel like these are coming into the business at a similar margin to the, say, 15% margins, which is where we hope this division Solutions will get to in the next few years? Could you talk a little bit about the timeline of producing them, the phasing of revenues, whether it will be even? And if there is any colour you can help us with on whether this should be broadly in line dilutive or accretive to the overall division? That would be helpful.

Alexander Kara: Yeah. I mean, we have announced that we start production of the first cables for SuedLink in Karlskrona and we will continue in the second half. And we also plan to start with SuedOstLink towards end of Q2 in Cologne. And so, there will be a revenue contribution in 2022, and this revenue contribution in 2022 is reflected in overall guidance.

Max Yates: Okay. And anything on sort of profitability versus the rest of your division? Is it meaningfully different to what to say?

Alexander Kara: Yeah. I mean, we said that we are satisfactory with the margin. And when we booked this project and have top margin and since then the status has not changed. But we are still in early stage. On POC, we are really on a low level at the moment, but we start also just now production.

Akash Gupta (JP Morgan): I joined this call a bit later. So apologies if this have been already addressed. But my question was more in general the tendering activities and the negotiation that are taking place with your customers before you signed the perm orders. I mean, we have seen inflation and one of your competitors was saying that the bids you placed last year, or I mean they placed last year is costing 30% more this year because of inflation, and obviously that is delaying some of the customers negotiations. So the question I have for you is that we have a robust pipeline, but do you see any risk that the growth might take longer to materialise because of the inflation that might impact customer decision at especially in Solutions segment?

Alexander Kara: No. I mean, we see, of course, this inflation in various elements, in salaries, in electricity prices and so on and in the project, which are not awarded to. We include that in our cost calculation. And so far, we have not seen that this is limiting the growth or that the orders get postponed because of this inflation.

I mean more substantial is the increases in raw material copper, aluminium, you compare to steel if you compare it to a year ago, but this is simply how it is. But to answer your question, no, we do not see any delays or impact.

Kristian Johansen (SEB): I have two questions. So first on Applications. Again, and just diving one-step further down on low and medium voltage. It would be my understanding that the low-voltage cables are more cyclically driven, to a large extent, by the construction activity industry, while medium voltage that is more structural driven by the electrification upgrades. So first, do you agree to that?

And then secondly, can you help us putting a bit of colour on the growth you are seeing in Q1? How much is driven by low-voltage and medium voltage? Do you see the same explosive growth in both segments?

Alexander Kara: Yeah. I mean, we share your view with the construction business that influence the low-voltage business and more of an electric structure over the medium voltage one kv and then the higher voltage. So we see a high demand in low-voltage say building bias in one kv and medium voltage across all countries, across with all products strong. And I think we mentioned it also in the Q1, for example with [inaudible] in Poland with strong performance.

And as of now, we do not see a sign that this will change. But of course, a short cycle business, building bias. It could change rather quick. I mean, we are talking here from the backlog to execution two, three months. And then, we need to refill the pipeline quite fast. So that piece of course is hard to predict. But so far, we see a super strong market in the markets where we operate.

Kristian Johansen: I understand. And the €10 million EBITDA you are making in Applications in Q1. Can you split that between low voltage and medium voltage?

Alexander Kara: No, we do not split it. But I can tell you that we have a high utilisation output in all the factories.

Basil Garabet: Internally, we, of course, split it, but we –

Alexander Kara: Internally split it, yes.

Kristian Johansen: All right. That is fair enough. And then my second question, I just wanted to understand, you are right that you are booking €1.1 million in one-off costs related to the NKT Photonics review, but you booked that in the cable business. Can you just help me with the reasoning for that cost ending up in the cable business?

Line Andrea Fandrup: So, as you can see, it is the Group and here, they are holding the cable that actually is facilitating the strategic review of Photonics. Therefore, it is booked like that, like nothing more into that.

Alexander Kara: Okay. If there is no further questions, then thank you very much for your time, your good questions, and hope to talk to you soon. Have a good day. And bye-bye for now.

[END OF TRANSCRIPT]