

# **Chart Industries, Inc. (GTLS) Q1 2024 Earnings Call Transcript**

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**Body**

Chart Industries, Inc. (GTLS)

Q1 2024 Earnings Conference Call

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Company Participants

Jillian Evanko - President, Chief Executive Officer

Joe Brinkman - Chief Financial Officer

Conference Call Participants

Martin Malloy - Johnson Rice

Marc Bianchi - TD Cowen

James West - Evercore

Ben Nolan - Stifel

Roger Read - Wells Fargo

Eric Stine - Craig-Hallum

Robert Brown - Lake Street Capital Markets

Pavel Molchanov - Raymond James

Manav Gupta - UBS

Ati Modak - Goldman Sachs

Presentation

Operator

Good morning and welcome to Chart Industries, Inc. 2024 First Quarter Results Conference Call. All lines have been placed on mute to prevent background noise. After the speakers' remarks, there will be a question-and-answer session.

The company's release and supplemental presentation were issued earlier this morning. If you have not received the release, you may access it by visiting Chart's website at www.chartindustries.com . A telephone replay of today's broadcast will be available approximately two hours following the conclusion of the call until Friday, May 31, 2024. The replay information is contained in the company's press release.

Before we begin, the company would like to remind you that statements made during this call that are not historical, in fact, are forward-looking statements. Please refer to the information regarding forward-looking statements and risk factors included in the company's earnings release and latest filings with the SEC. The company undertakes no obligation to update publicly or revise any forward-looking statements.

I would now like to turn the conference call over to Ms. Jill Evanko, Chart Industries' CEO. Thank you. Please go ahead.

Jillian Evanko

Thank you, Ina. Good morning, everyone. Thank you for joining Joe Brinkman, our CFO and me to walk through our first quarter 2024 results. For all periods referenced, all metrics are pro forma for continuing operations of the combined business of Chart and Howden, unless otherwise noted.

Starting on slide five of the supplemental presentation, the first quarter is typically our lowest quarter of the year, and this year is expected to be no different. What is different is that the first quarter of 2024 was stronger than our typical Q1 across the board, resulting in setting first quarter records for orders, backlogs, sales, reported and adjusted gross margin, reported and adjusted operating margin, reported and adjusted EBITDA, and associated EBITDA margin.

To summarize, orders were up 4%, organic sales up 18%, reported EBITDA up 73%, and reported gross margin up 260 basis points. We'll discuss comparative financial metrics on the next slide, but a few standout items.

First quarter sales of $950.7 million grew 17.4% or 18.3%, excluding the foreign exchange headwind in the quarter. Also, Q1 2024 sales were our second highest sales quarter ever in our history, which is rare for a Q1. It also sets the stage for sequential growth in 2024, as we have not yet had a full quarter of Teddy2, our Theodore, Alabama, jumbo cryogenic tank facility, and our Tulsa facility CapEx, that is still in progress.

Reported gross margin of 31.8% was an increase, as I mentioned earlier, of 260 basis points compared to Q1 2023. This was also our second sequential quarter with gross margin at or above 31.8%. And all quarters, since we closed on the Howden acquisition, have been above 30% reported gross margin. This, as well as seeing the P&L benefits from our synergy actions taking hold, drove adjusted operating margin of 18% and adjusted EBITDA margin of 22.3%.

Similar to gross margin, this is the second sequential quarter where adjusted EBITDA margin has stepped up to be at or above 22%. And since the acquisition of Howden, each quarter has been at or above 21.5% adjusted EBITDA margin.

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Strong end market and Chart-specific demand continues, resulting in record backlog of $4.33 billion. Demand is also reflected in our increasing commercial pipeline, our highest ever at over $22 billion, up from approximately $21 billion prior. We have identified more synergy opportunities, open production at Teddy2. And so, in turn, there's an increase in our commercial funnel for marine, space, and rail, water treatment traction, and we're seeing broader content on international LNG projects, to name a few contributors to this increased commercial pipeline.

First quarter 2024 orders of $1.12 billion included record repair, service, and leasing segment orders, which increased 10.5% compared to Q1 '23. We also saw first quarter stronger demand than typical in our European industrial gas end market. We're seeing that strong start already through April. All of this resulted in a 1.18 book-to-bill, which is expected to continue to be above one through the year. This strength in terms of Q1 versus typical Q1 is also a contributor to us reiterating our full year outlook for 2024.

Slide six shows the first quarter of '24 versus pro forma first quarter of '23. I'd point you to the far-right hand column, which is the year-over-year changes in each metric. On the prior slide, I commented about the 18% adjusted operating margin. This is a 620 basis point increase compared to last Q1.

Both reported and adjusted EBITDA margin grew more than 550 bps as shown in rows 10 and 12. An adjusted diluted EPS of $1.49 reflects a higher first quarter 2024 tax rate than is anticipated for the full year as we continue to expect full year ETR of approximately 20%.

Finally, free cash flow was negative $136 million, which included $47 million of CapEx, $24 million of that related to our Teddy2 facility. This free cash flow was in line with our internal expectations and included specific first quarter cash outflows that are shown on slide seven.

As we shared on our fourth quarter '23 earnings call, the first quarter always has specific cash outflows that occur once a year and there were other specific cash outflows related to the 2023 divestiture fees and the Teddy2 manufacturing facility CapEx payment. As you can see in rows A through G on the table on slide seven, there were $219 million of specific first quarter cash outflows outside of working capital and normal course CapEx. Approximately $165 million of these are not expected to repeat in the second quarter 2024.

On the bottom left-hand side of the slide, you can see that we continue to opportunistically optimize our balance sheet, and we recently completed an amendment to our revolving credit facility with very strong bank support. This extends our RCF maturity date to 2029 and we received other favorable changes to terms and conditions.

We continue to reiterate our financial policy as shown on the bottom right of the slide until we are within our target net leverage ratio range of 2 to 2.5. As I commented, there were about $165 million of specific cash outflows across five items that will not repeat in the second quarter.

Turning to slide eight. You can see our outlook for free cash flow in Q2 is approximately $175 million. It's clear we need to be explicit to align outlooks on free cash flow based on quarterly information and therefore we are providing the next quarter's outlook and we'll do the same for the third quarter at the end of the second.

Our Q2 cash outlook is driven by the non-repeating Q1 cash outflows as well as by items shown on the lower left-hand side of the slide including sequential improvement in working capital. We anticipate the receipt of project payments in Q2 of approximately $125 million across our top projects and additional collections obviously beyond those globally.

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We also expect lower and final sequential CapEx related to Teddy2. We did have $6 million of Q1 CapEx for our Tulsa facility to increase capacity and throughput on the Braves line there and $2 million for our GOFA trailer facility expansion in Germany, all of which have existing backlog that will flow through these locations in the second half of 2024. And finally, we have no second quarter semi-annual cash interest payment. To date, second quarter 2024 cash generation has started strong.

Turning to slide nine. A few points on the segment results. Starting with Cryo Tank Solutions or CTS. First quarter CTS orders of $159 million decreased about 4% when compared to the first quarter of 2023 driven by a large rail car order booked in the first quarter of 2023. The increase in CTS orders sequentially from the fourth quarter of 2023 is what is important to today in our outlook as we see continuing pickup in demand in global industrial gas as well as having completed certain large customer long-term agreement renewals in March and April of 2024. Additionally, the first quarter general industrial orders within CTS were the highest in our history.

First quarter CTS sales of $160 million increased 13.6% when compared to the first quarter last year. This is very strong year-over-year growth given that typically CTS grows in low to mid single digits. Reported gross profit margin of 20.5% is back in its normal range coming off of the 2021-2022 lows from material price cost lags.

Next Heat Transfer Systems or HTS. First quarter '24 HTS orders of $237 million decreased about 30% when compared to the first quarter of '23 primarily driven by specific large project bookings in the first quarter of '23 including big LNG. March 31st, HTS backlog was about $1.7 billion and does not include the IPSMR International Big LNG Award from an IOC that we expect to book in early 2025. First quarter '24 HTS sales of $254 million had associated reported gross margin of 27.6%, a 160 basis point increase compared to the first quarter of '23 and sales increased about 35% for HTS.

Moving to RSL which is a gem of a segment when you look at margins in particular. First quarter '24 RSL orders were records at $334 million. Orders increased 11.1% and associated sales of $301 million increased about 15% when compared to the first quarter of '23. It's also worth noting that we have had orders and sales growth above 10% consistently each quarter in RSL since we closed on the Howden acquisition.

We're seeing a lot of demand in particular in APAC for upgrades to refineries for environmentally friendly equipment. Reported RSL gross profit margin of 46.7% was another RSL record and gross margin in RSL has been above 43% each quarter since we closed on Howden.

And finally, Specialty Product segment. In the first quarter of '24 Specialty Products orders were $391 million which increased 40.5% compared to the first quarter of '23 and decreased about 2% when compared to the fourth quarter of '23. The sequential decline was primarily driven by a decrease in marine projects as we had a very strong fourth quarter '23 marine bookings.

We expect marine and maritime bookings to increase throughout 2024 as we now have the Teddy2 capacity. We'll come back to marine and heavy-duty sustainable transport applications in a few slides.

Returning to Specialty, in Q1 we had our highest ever order quarter for carbon capture utilization and storage, or CCUS, in our history, driven by increasing activity in larger size projects for us in particular in Earthly Labs.

First quarter of '24 sales of $237 million increased 6.7% compared to last year and sequentially increased just over 10% compared to the fourth quarter of '23, driven by timing of project revenue and the start of Teddy2 pre-production.

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Reported gross margin in Specialty was about 25% and this was lower than we expect for the rest of the year due to specific project mix and first of the kind project in the first quarter. We do bring first of the kind projects in as there are multiple volume opportunities ahead as well as aftermarket associated with the new build.

On slide 10, we're showing the historical last 12 months or LTM pro forma trends. A key takeaway from this slide is that despite potential quarterly variances due to customer timing, the trend lines are all positive. I'd also point out that there was no significant drop-off in our order book even when considering $620 million of Big LNG orders in 2022. This is another way that shows the diversity of our end markets and the resilience of our aftermarket business.

We've grown sales to $3.7 billion on an LTM basis from $3.3 billion in 2022 and taken our gross profit margin to 31.6% on LTM from 27.8% in 2022 and we feel that this is just the beginning as our demand remains robust.

Our backlog and commercial pipeline are both benefiting from key macro tailwinds of which four of the main ones are shown on slide 12. First, starting in row one is global energy access. This is not only access, but security, stability of energy and the fact that the world uses energy in everything we do. We continue to expect natural gas and LNG to be a part of this. Our customers are telling us this. The proof though is in our backlog with a variety of global gas associated orders.

Let's spend a minute on some things happening in the LNG market. You have the Cedar LNG project moving ahead with Chart content, multiple LNG players buying their own ship fleets and a lot of infrastructure being built globally. Beyond natural gas and LNG, hydrogen continues to have public and private support and we're seeing this across multiple types of orders ranging from liquefaction to storage to end use, including recently receiving a duplicate of our largest liquid hydrogen storage order in Europe to date. We also have strong visibility to the second quarter in the rest of the year, in particular in our hydrogen pipeline.

Moving to row two, as we say in our nexus of clean, clean power, clean water, clean food, and clean industrial are all intertwined. This is the case with the macro driver of clean water scarcity, and it's getting more and more attention, in particular with the recent U.S. EPA designation of PFAS as hazardous substances. It's also important to note that in certain countries, clean water is a major political platform for government officials, and clean water touches clean power, when speaking to green hydrogen as an example. In a couple of slides, we'll discuss our Chart water offering and the associated commercial opportunity.

So moving to the third row, as discussed in item one, there's growing demand for energy, period. It is in part being driven by artificial intelligence and data centers, which need electrification, energy storage, backup solutions, and cooling. All these applications that are offering very well, inclusive of CCUS, specialty compression, fans, air coolers, just to name a few. We have specific near-term commercial opportunities in these applications for data center heat rejection, power generation for baseload and peak shaving, and energy storage.

Just this week, the U.S. DOE's H2S Scale Initiative announced that a hydrogen demonstration facility is launched in Texas to provide power to the Texas Advanced Computing Center, or TACC. And please recall that we are one of the partners in H2S Scale.

The fourth row on the slide is the need to address existing and build new infrastructure, combined with a focus on decarbonization, especially in heavy-duty transport applications. This is supported, again, by both the public and private sector, including with Biden Administration's March 25th announcement of $6 million of awarded spend via DOE for demo projects to reduce GHG emissions in heavy industrial applications. The private sector is progressing this as well, with collaborations to study and develop low-emission trucks, trains, ships, and airplanes. And as one reason, we're very well-positioned with our new Teddy2 tank facility to serve these larger applications, in particular, in liquid hydrogen.

So turning to slide 13, with our Teddy2 facility and total solution offering globally, we're able to serve much larger heavy-duty transport applications, including aerospace exploration, additional rail, and onboard marine and the associated onshore infrastructure for liquid hydrogen. One such example is our new partnership with Energy Observer, specific to the Energy Observer 2, a liquid hydrogen cargo ship under development. The aim is to build an integrated hydrogen ecosystem, reducing the overall cost of liquid hydrogen and promoting its use in maritime transport.

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The establishment of a low-carbon maritime energy hub, combined with low-carbon hydrogen production, and the installation of port infrastructures, is essential to achieving these objectives. And we'll partner on associated equipment and technology, both with Energy Observer and their other partners.

Another example is our recently executed MOU with GasLog LNG services, to study the development of a commercial-scale liquid hydrogen supply chain, leveraging GasLog's latest development of a liquid hydrogen vessel, and our extensive experience in cryogenics and large-scale liquefaction solutions for the global distribution network and infrastructure.

Our commercial pipeline for marine LNG, space exploration, and rail for our Teddy2 facility is over $400 million. Since we officially opened the facility a month ago, we have added an incremental $80 million to the commercial pipeline for this facility of potential opportunities.

As you can see on slide 14, we have solutions and products that serve the macro tailwind we discuss the water, treating contaminants, including PFAS, arsenic, biological processes, to name a few. Currently in our commercial pipeline, we have 65 opportunities for PFAS, specifically. 11 of those are new since the beginning of this year.

As we've stated numerous times over the past year, there have been many benefits of the Howden addition to our business. One of the top on the list is the expanded aftermarket opportunity, as shown on slide 15. RSL is 32% of our total revenues in the first quarter, and with sales growth of 14%, consistent order growth over 10%, we're set to have this high margin business become a larger part of our mix in the medium term.

I'll now hand it over to Brinkman to talk about 2024 and our medium term outlook.

Joe Brinkman

Thanks, Jill. On slide 16, to round out the key driver section, we show our main supply chain inputs. Generally, these have normalized from the highs we saw in 2021 and 2022. Carbon, stainless, and aluminum are all relatively stable and each near their lowest -- lower points over the past three years. We continue to watch very carefully given the Red Sea situation, yet have not seen meaningful cost changes from it to date.

Turning to slide 18, with the foundation of the macro and specific key drivers we just went through, and based on our first quarter 2024 results being in line with our internal expectations, we reiterate our outlook.

Slide 19 is an update to a slide we introduced in early November 2023 for considerations when you're modeling our 2024. Under positives, we have begun certain production in our Teddy2 facility, so that is tracking well for 2024 revenue based on existing backlog. Additionally, we have approximately 63% of our next 12 months outlook covered in backlog, and we are seeing a trend towards larger project sizes, especially for Howden content.

As stated on our Q4 earnings call, we surpassed our year one Howden cost and commercial synergy expectations earlier than originally anticipated. We are well underway on additional year two synergies. In the middle column, it is worth noting that while we are not dependent on the U.S. IRA to achieve our financial targets, we anticipate the 7 hydrogen hubs having potential incremental benefit to our backlog as they are deployed.

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When you think about our year and how the quarters play out, there are a few items to consider, including, but not limited to, further synergy realization timing in the back half of 2024, Teddy2 revenue sequentially ramps throughout the year. Specific larger projects that came into backlog in Q1 of 2024 will be later in the year revenue and into 2025.

You can see our return on invested capital targets on slide 21. Our medium term outlook for ROIC is mid-teens, coming from a jumping off point of the last three-year average of approximately 8%. We have made significant organic and inorganic investments to position our company for growth and are in the early days of reaping the associated benefits. Howden is accretive to our ROIC and we now have less cyclicality with a shift to a higher portion of our business in aftermarket service and repair.

On slide 22, we again reiterate our medium term financial outlook as we had previously shared in November 2023 and reiterated in January 2024. We have multiple contributors to achieving these, including our full solution mix is broader than just LNG and hydrogen, as you've heard today, and we play across the entire value chain globally. We now have a higher mix of aftermarket and services revenue and an incredibly large, diverse and global installed base.

Price/cost continues to be a positive driver for us. Volume productivity and other Chart business excellence activities continue. And we have a mid-term target of mid-30s for a gross profit margin on an LTM basis. We are at 31.6%, up nicely from a year ago and well on track to reach our 2026 targets. And last, but certainly not least, we are benefiting as the industry is moving to a modular approach and IPSMR demand is going international.

Jillian Evanko

Thank you to our entire OneChart global team who delivered the record first quarter while continuing to deliver year two synergies in the safest way possible, with a total recordable incident rate of 0.52 and 70% of our locations around the world having had 12 months or more without a recordable incident.

Keep the momentum team safe with stakeholder orientation, strong work ethic, and giving back to our communities in operations. So thank you again to the OneChart global team.

Ina, please open it up for Q&A.

Question-and-Answer Session

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. [Operator Instructions]

Your first question comes from the line of Martin Malloy from Johnson Rice. Please go ahead.

Martin Malloy

Good morning.

JillianEvanko

Hey, Marty.

Joe Brinkman

Hey, Marty.

Martin Malloy

Hi. First question, I wanted to ask about the RSL segment and you've delivered several quarters of growth there in the order outlook. And I just wanted to try to -- if you could maybe talk a little bit more about the runway there and some of the drivers that are impacting this. Is this just the putting more equipment through all the service centers that you acquired through Howden, monitoring the equipment in different ways? If you could maybe talk about that a little bit.

JillianEvanko

Absolutely. And thanks for starting with RSL. I mean, as I commented in the prepared remarks, it really is a gem of a segment, double-digit growth in orders and sales throughout the time we've had Howden. There's still quite a bit of runway here. And one of the things that we're doing as part of our year two synergy activities is we've created a global revenue operations team led by one of the aftermarket leaders of Howden that is going to pull together all of the remaining install base from Chart legacy. And we're going to drive what we did in year one through that.

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There's dozens of other actions well underway to continue to take advantage of the runway that exists here ranging from the digital uptime install base. We did have our first digital uptime connection in Earthly Labs with real ale breweries this past quarter. And so there's opportunities like that as an example.

In terms of drivers impacting the margin in the first quarter, we had a very strong mix in the Americas. In China RSL, we had very strong manufacturing operations efficiencies. And so we see that opportunity continue ahead. In terms of drivers of the demand and why are we continuing to see this double-digit demand. The first thing I would say is because of the global footprint that we have and the ability to serve the world versus just North America and a little bit of EU like we had in Chart legacy is really a key contributor.

We're also seeing a real strong push in many of our new build customers for decarbonizing their existing facilities and locations in particular in the mining segment where the need for again clean air, hotter deeper mines is driving some retrofits happening there. And then lastly, we are seeing some repair service retrofit activity on existing facilities and LNG as well.

Martin Malloy

Okay, great. And then for my second question, I wanted to talk about the water side and the new EPA regulations and kind of what it means to Chart in terms of the scope that you're potentially able to sell into a municipal water plant.

JillianEvanko

Yeah. So this is an interesting one and certainly the EPA new regulations are going -- we believe are going to be a catalyst in this area for our business. Recall and step back we acquired AdEdge Water Technologies as well as breweries over the last four years to really bring the capability to treat any contaminant across the board. The AdEdge Water Technology is the one that targets the PFAS in particular and we've had an increase in our commercial pipeline.

I think you're going to see this take a little bit of time to flow through in terms of the order book and in terms of the activities. Certainly, private sector companies are trying to figure out what does it mean to them? What are the steps that they're doing? But just this year fact that we had 11 new opportunities out of our total of 65 enter the commercial pipeline since the beginning of the year. So the people are at least thinking about and talking about it. So I viewed it as a medium term catalyst for us and we're really well-positioned to do that.

We're seeing a lot of international opportunity not to not specific to PFAS, but rather to arsenic and so that we're our treatment system is very targeted for that as well. And we've seen some really good international orders over last 12 months with a strong pipeline ahead. So while water is a single digit percent of our total business like in low single digits, the runway for growth ahead is really exceptional and there's not a macro tailwind that doesn't support that.

Martin Malloy

Great. Thank you very much. I'll turn it back.

JillianEvanko

Thanks, Marty.

Operator

Thank you. And your next question comes from the line of Marc Bianchi from TD Cowen Cowan. Please go ahead.

Marc Bianchi

Hi, thanks. I wanted to start with the orders. So solid orders here in the first quarter, but it didn't seem like there were any large items that were contributing. So the question is sort of, is this a good baseline level of orders to think about and then we can add large items to that. And then when I look at the year-over-year progression, I think last year you had some Big LNG in it and if I take that out the growth rate is kind of like 20%. So that seems pretty high for a base level, but maybe you could talk about the base level outlook and sort of what the growth rate for that should be.

JillianEvanko

Yeah. Thanks Marc. And definitely a strong order quarter especially for a Q1. We normally wouldn't have seen such broad base in a Q1 just coming off of people spending Q4. So that's a good robust demand indicator that we see.

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One of the things that is happening in terms of our businesses, the more -- we're taking our products into these high growth end markets that are solutions that are oriented or project oriented is we're now starting to get more frequent kind of medium sized orders and it's not dependent on just LNG as an example or just hydrogen as an example. I do want to pause there and say we have a really good line of sight on strong Q2 hydrogen order activity. So I expect that's going to continue.

So it's hard to call out -- we always historically had called out Big LNG because that was really the thing that the only kind of large of its size. And now there's more consistency in the medium sized projects in multiple end markets. And so to directly answer your question, I would expect that robust demand continues. If you look back over the last, I think, seven quarters, six of the seven were billion dollars or above. So that's kind of the proxy that I use on it or the one book-to-bill -- kind of consistent one book-to-bill on a regular basis.

From Q1 to Q1, you're correct. We did have the large LNG activity, Big LNG, large project activity in the first quarter of '23. We were pleased though, when you look at peers and other industrial and other oil field companies, you look at it and having just orders period up 4%, we were very pleased with kind of the absolute metrics in the first quarter, especially again coming off of such a strong fourth quarter.

Marc Bianchi

Yep. Okay, thanks for that Jill. And then the other one I had was just on free cash. So if you're going to do the 175 in the second quarter, that's $40 million for the first half approximately. You'd need to be doing 550 in the back half to be to the midpoint of guidance. And that's like a really high conversion of what consensus has for the back half of EBITDA, which I think is -- there's some exceptional items expected there in the back half. Could you talk about what those might be? If there are one-off cash inflows in the back half that are supporting the outlook, maybe there's some seasonality in there. And what the sort of run rate conversion of EBITDA ought to be when we get past all this Howden noise.

JillianEvanko

Okay. Yeah. So stepping to the first part of your question, I'm going to try to take it in pieces, Marc. What I would say is that we do have -- quarter-to-quarter, we have movement between that, between working capital, AR AP, just kind of normal in our business. There's nothing in working capital outside of the fact that inventory has spikes, right? We have good line of sight of our CapEx timing. So 2H CapEx in particular is going to step down from the first half of our CapEx in 2024.

I'd also point to some of the things that we had just on Q2 on slide eight that we talked about around project milestone payments and project payments. So these are payments for work done. They're not payments for buying material or anything like that. So that -- we called out a few there for the second quarter. If you look at kind of how are your ramps based on more projects coming into backlog in Q4 '23, Q1 '24, that kind of -- that is the number one outside of normal course and CapEx step down. That will really sequentially drive 2H higher from 1H on cash.

One rate conversion was, I think, the last part of your question. Yeah, we looked at it as free cash flow as a percent of sales and kind of mid-teens is our target.

Marc Bianchi

Got it. Thanks very much. I'll turn it back.

Operator

Thank you. And your next question comes from the line of James West from Evercore. Please go ahead.

James West

Hey, good morning, Jill.

JillianEvanko

Hey, James.

James West

So really nice first quarter execution. Good order, especially relative to your global industrial peers who are all down in terms of orders. So just wanted to highlight that. But really my first question is around both CCUS and hydrogen and kind of what you're seeing there in terms of demand and what you think gets pulled forward first, because we've had this kind of multiyear of back and forth on, well, it's hydrogen. Well, it's CCUS. And I'm kind of curious, it seems like both are actually starting to go and starting to get pulled forward and starting to move, kind of attend them now. I'm curious if that's -- what you are -- if you agree with that, if that's what you're seeing in terms of demand.

JillianEvanko

Yeah. Thanks, James. And first of all, thanks also for the call out on the absolute first quarter metrics. We were extremely pleased with those. When you look at CCUS and hydrogen, I think you summarized it perfectly in terms of what we're seeing where they both seem to be increasing in activity and in some cases together. Our first quarter being our highest order quarter ever in CCUS is an indicator of that. You know better than anybody that I've been talking CCUS for four years and it's just been a little bit slow to get rolling. But now we're seeing real projects and what I would say that's super interesting from our view in our portfolio that we're seeing the Earthly Labs offering, which we call small scale, is now what was originally $0.5 million orders, we're now getting $1 million to $5 million orders because the size is increasing. So the scale is increasing and I think that you're going to see that continue to be a key part of all of this.

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Then you start getting down the path of like the data center stuff and how CCUS correlates with that. There's an immense amount of opportunities associated with the need for CCUS with respect to data centers.

Hydrogen, we've seen hydrogen being fairly consistent. I was very pleased with the fourth quarter and the first quarter hydrogen activity, mainly setting aside the absolute dollar amount and number of projects, the fact that it is truly going global. We're truly seeing real projects with real money behind them ranging from compression for heavy industrial in Europe to the liquid hydrogen storage tanks in Europe.

That one's interesting to me too, because historically Europe has been gaseous mainly and now we're starting to see some liquid infrastructure coming into play. But we highlighted the Energy Observer, because you're seeing now a correlation of hydrogen, liquid hydrogen for heavy-duty transport and the onshore infrastructure. So good momentum.

The thing that we do watch carefully is the fact that you have a lot of people that want to do projects in hydrogen and not all of them get to FID. And so ensuring that there is funding available, financing available for these types of projects is something that we watch carefully.

And then my last comment realizing it's a very long answer that we do think the hydrogen hubs in the United States, the seven, are going to pull less around the projects that they're going to do here. Likely later this year, early next in terms of when you start to see some of those orders get deployed to the supply chain.

James West

Right. Okay. Okay. Got it. And then maybe just a quick follow-up for me on the margin. The margin performance was excellent in the quarter. And curious, and I know you guys aren't stopping here. You're going to take that margin higher. But how much more room do you think we have to go with respect to margin? And have we seen the full benefits of Howden and the increased aftermarket in the margin yet? Or is there still some -- I guess easy pickings to see here in margin performance?

JillianEvanko

So we definitely, as Brinkman said, have that medium term outlook, which is the mid 30% gross margin and well, well on our way to that. There's much more ahead here. I think what you see year one with Howden was great. And now we're kind of in a cadence. And now what we're seeing is, okay, let's optimize. Let's look at where there's efficiencies and where year one it was really low hanging fruit, and now it's really about the optimization.

A good example is we had the opportunity to consolidate as we operate internally a couple of our regions together. And so there's these savings there just from having a certain number of entities as an example. But definitely more room to go. And I think the other side of it is the more project business and full solution business that we get while understand that it's not -- it's hard having movements between three months periods or quarters is actually a really good thing. If you look across a year or 12-month period to the margin profile, because we're getting that engineering work, the technology and the equipment associated with it.

And I think we had somewhere in our notes that the project sizes for our content are getting larger in particular on Howden. I was chatting with one of our Howden presidents that had done with business for many years. And he said, I've never seen before this number of projects in our commercial pipeline that are above $5 million, because typically $5 million historically for Howden on its own would have been a big work. But now that portion of the total project size is for them is getting even larger. So tons of opportunity.

And then my last answer to your question is RSL aftermarket. It's not -- it's done exactly what we wanted it to do in terms of margin, in terms of growth. And in terms of helping us not have that whips off the totality of a Big LNG project goes away or something like that.

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James West

Got it. Thanks, Jill.

JillianEvanko

Thank you, James.

Operator

Thank you. And the next question comes from the line of Ben Nolan from Stifel. Please go ahead.

Ben Nolan

Thanks. Hey, Jill and Joe.

JillianEvanko

Hey, Ben.

Joe Brinkman

Hey, Ben.

Ben Nolan

I have a couple. The first, I wanted to go back to the RSL and appreciating that it's probably an area where you're capturing some of the most synergistic benefit from the Howden acquisition. But what -- I think it's a little over a third of the revenue mix, now it's growing a pretty good clip. Longer term, what do you think, Jill, is a fair assumption for what RSL will be out of revenue after things settle out? I mean, is it going to be half of what you do or 40%, just curious how you're thinking about where we land?

JillianEvanko

Yeah. Thanks for the question, Ben. And thanks for the call out on RSL. I mean, as I just said, it's just really done what we expected it to do and in some cases more. There's a lot more to go here and I'm very excited about it. What I'm really excited about is you take like a first of a kind opportunity that we get on the new build side. And that's great, because historically we take the first of a kind to either be an innovator in the market or help market make or see a lot of volume ahead for the new build side. But now with the aftermarket presence that we have, we also take those types of first of a kind if we see a tail for the aftermarket repair service side of things.

In an ideal world, I think our split would be somewhere in the 45% for RSL. And that's a long, clearly based on the growth rate. So you do a math to get to the longer term. But I took your question to be where do we see it kind of in an optimal construct of the business.

Ben Nolan

Okay. No, that's helpful. And then the other question is, we have seen some elevated pricing for things like aluminum and carbon steel. And I know that that was an issue a couple of years ago. You guys took some steps to -- at the time, ensure that you could pass through those costs. Could you maybe just talk through a little bit how that stands if there is an element of -- whether we should see increased pricing in lockstep with increased cost of goods sold or is there any risk of -- a timing gap or anything like that?

Joe Brinkman

Yeah. As we've talked before, Ben, the pricing mechanisms that we have in place protect us quite well from changes in the carbon, the steel, the aluminum. We're able to -- for projects specifically, lock in the costs at the time of order, very nearly thereafter. So we have very little susceptibility to market swings. Like we had in the deck, the carbon steel and aluminum has largely stabilized. Aluminum has had a little bit of an uptick recently, but nothing too alarming. So we're well-positioned to pass increases in those costs along in the price/cost.

Ben Nolan

Okay. And just to clarify, about how much is the cost of those commodities in the cost of goods sold? I assume most of it's labor, but just to frame it.

Joe Brinkman

Those three commodities?

Ben Nolan

Well, you're -- basically your commodities as part of your cost of goods sold. How big of a slug is it?

Joe Brinkman

I would say it's less than 20% of the cost back.

Ben Nolan

Okay. All right. Thank you.

Operator

Thank you. And your next question comes from the line of Roger Read from Wells Fargo. Please go ahead.

Roger Read

Yeah. Thank you. Good morning.

JillianEvanko

Hey, Roger.

Roger Read

Jill, Joe. Yeah, I'd like to -- just maybe, Joe, some of the stuff you talked about on the medium term targets and getting the, I guess, the gross margins and ultimately the EBITDA margins up and Q1 did show progress on that. As you look within the orders, the backlog that you have, you mentioned discipline price/cost is part of getting there. Like, how is that developing? What is the visibility that you have within the orders and the backlog to say that that's holding and that's there? And then, how does that fit in also with the productivity part as you've now had Howden for a year?

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Joe Brinkman

Yeah. Well, just firstly on the visibility of increasing EBITDA and margin over time here. And we've got the -- over $4 billion of backlog, 63% of the next 12 months covered here. And we've got good visibility on the cost -- price/cost there. So we know where margin is going on a roll forward basis. That -- and as we highlighted in our earlier comments, we've got -- as every quarter progresses here, we've got more of the cost energies being realized and baked into our results here. That's just margin tailwinds, if you will. So -- and then we have Chart business excellence like I highlighted as well, generating additional cost out constantly. So we feel very strongly about our medium term outlook.

Roger Read

Okay.

JillianEvanko

And hey, Roger, one other point to that is the increasing mix of RSL just naturally helps us there.

Joe Brinkman

Yeah, definitely.

Roger Read

Yeah. No, that business has been great in terms of the study that's taking some of that seasonality out, as you mentioned. The other question I'd like to come to, and obviously you've had to put a lot of explanation into the one-time factors here in Q1, how the -- what you see in terms of margin improvement, how that's going to work in the cash flow generation and free cash flow generation as we go forward.

I mean, back at the time of the merger, I mean, different numbers were tossed around, but it was 80% conversion to free cash flow from cash flow. I don't expect that every quarter, but what's the right way to think about free cash flow conversion? I mean, 95% to 100% seems pretty strong, but we haven't seen that in the first few quarters here with the Howden deal. So I'm just curious how to think about that with the occasional -- does that include the interest expense payments, the other items that can come along on a seasonal basis?

JillianEvanko

Yeah. Thanks for that question. I think it's a really important one. I would say clearly, as I commented in my prepared remarks that we have taken the feedback that we need to be more explicit on kind of what does the next quarter look like, at least through 2024, given that it's our first full year of the combined business. And we've taken that to heart to try to give visibility to what we're seeing.

I think your point is extremely valid on how we ramp to that 95%-plus of the cash conversion in the medium term goal. And it's going to take a little bit of stair stepping to get there. But the metric itself does take into account all of the items that you referred to interest in these kind of different topics between quarters, like we talked about on Q1. So a ramp to get to that point, but certainly the increasing EBITDA of margin profile helps that, drives that, the fact that we anticipate continuing to paydown debt. So the discipline on our target to the net leverage ratio. And we've said toward 2 to 2.5 is our target. But in the near-term, in 2024, mid-2024, the high twos that we've said before.

So there's a way to get there. There's a path to get there. It requires us to continue to deliver margin, continue to paydown debt, and also we feel really good that there's more and more synergies out there that we're seeing that can help drive that.

Joe Brinkman

Yeah. And I would just add to that. As we highlighted in the earlier comments, we're coming off of a pretty significant CapEx expend cycle with $47 million in Q1 here, but for the year we expect that more on the $120 million range. So we're just finishing up on some very large CapEx expenditures needed to convert backlog, add that additional throughput, which is going to drive the sales. And the CapEx expending will come down as a percent of sales here towards the end of this year and into 2025.

Roger Read

Okay, thanks. Appreciate that. Yeah. And I mean, like James said earlier, right, I mean, the order trends backlog for you all are much better than what we're seeing from others. So next step to conversion, right? But thanks and good luck.

JillianEvanko

Thanks, Roger. Appreciate it.

Joe Brinkman

Thanks.

Operator

Thank you. [Operator Instructions]

And your next question comes from the line of Eric Stine [Craig-Hallum]. Please go ahead.

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Eric Stine

Hi, Jill. Hi, Joe.

JillianEvanko

Hey, Eric.

Joe Brinkman

Hey.

Eric Stine

Hey, so maybe just go back to the carbon capture a little bit. I know you touched on it earlier. But just want to kind of contrast it with how you've discussed it in the past, and I know you've viewed hydrogen as what, 12 to 18 months ahead. Is this quarter, given your commentary, something where you think it actually is now going to be a more repeatable, predictable business? You still think this is kind of stops and starts here in advance of that? Just maybe how are you thinking about that and maybe contrast it with where hydrogen is in its kind of development?

JillianEvanko

Yeah. Thanks for pointing it out, because we are -- as you know and one of our longstanding followers, we've talked about it here for four and a half years. And I think that it took longer than I -- certainly we had anticipated, but we're pleased to get the technologies in when we did, because it allowed us to really develop early feed and pre-feed relationships with a lot of the folks that some of them will move ahead.

So I think it's definitely starting to be real and tangible. We actually debated internally as to how to talk about -- at some point here, we're going to start talking about carbon capture, water as a percent of our total business because they're starting to get sticky enough that that's a metric that can give you guys a jumping off point. We didn't do it this quarter, but it's pretty damn close to being ready to share that. So that is a qualitative statement, but I definitely think that what we're starting to see is global traction on carbon capture.

I also think that it's -- in the last few years on carbon capture, it was really okay, you've got people doing demonstrations or you have in our case Earthly, which had great traction from day one because it was economical, easy to install solution, and solved for CO2 shortages. The larger scale was taken a little bit longer, but now we've got the pipeline that we had before and an increasing pipeline related to all of the discussion that you hear on artificial intelligence and all of these kind of energy-intensive actions. And so I think that's also kind of a relatively near-term catalyst.

Is it 12 to 18 months behind hydrogen? I think it's accelerating, so it was really kind of three years behind hydrogen, in my opinion, but we're seeing it accelerate. And certainly, with Q1 orders in carbon capture being a record, that's a pretty good place to jump off from as we head into the rest of this year.

And then maybe my last data point for you on carbon capture is, yeah, we've got our highest backlog in carbon capture as of the end of the first quarter that we have ever had, obviously given record quarters, but it's sequentially stepped up. Backlog has sequentially stepped up, or essentially doubled since a year ago for carbon capture.

Operator

Thank you. And your next question comes from the line of Bob Brown from Lake Street Capital Markets. Please go ahead.

Robert Brown

Good morning, Jill and Joe.

JillianEvanko

Good morning.

Robert Brown

I just wanted to follow up on the year two synergy kind of effort on, I guess, the cost side. What's sort of the key areas you're focused on, and how do you see that playing out for the rest of the year?

JillianEvanko

Yeah. It's interesting because as we said at our Q4 earnings call, okay, we surpassed early both the cost and commercial synergies, and we're going to keep going on years two and three. I've said that externally we'll let you know when we hit a billion dollars in commercial synergy orders, and we're well on our way toward that number, certainly to be achieved here in the coming next couple of quarters, if not in the next quarter.

And on the cost side, it's really around, year one was heavy low hanging fruit, hitting our supply base, restructuring facility consolidations were applicable, which there were only a few there. And now we're into is things like entity rationalization, where we can optimize entities from a cost standpoint, but also you get benefits like tax savings and ETR benefits, which Joe will think referenced in his comments, and things around just tangible costs like audit fees, right, where you had audit fees for 10 different auditors on statutory or larger costs in year one, that type of thing.

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So lots of different activities, but we'll continue to optimize. And I also think that the more we get to know the businesses, the more we're taking advantage of the talent throughout, and they're coming up with new cost energy ideas. So we are tracking as of today to be on track for our year two target from the original acquisition model for cost and commercial.

Operator

Thank you. And your next question comes from the line of Pavel Molchanov from Raymond James. Please go ahead.

Pavel Molchanov

Thanks for taking the question. You flag the Chinese LNG orders. And I remember a decade ago when PetroChina was your biggest customer of -- the whole company. Are we seeing another LNG transportation boom in China, or is this caused by something else?

JillianEvanko

We are definitely seeing LNG transportation infrastructure. I'm not sure I'd call it a boom yet, Pavel. Perhaps like a recovery taking advantage of lower natural gas prices. But this is very broad based, so it's not concentrated with any one particular customer. So we're seeing multiple orders related to, in particular, the LNG trailer side. So I think it's reflective of having been lower the last couple of years, but also reflective of the fact that LNG natural gas is everyone's view. I guess, I can't speak for everyone, but broadly our customers are saying it's going to continue to be a key part of their mix, their infrastructure, and their energy source. So I think we'll continue to see that infrastructure for LNG, in particular on transport and ISOs movement in port terminal, that type of thing.

Operator

Thank you. And your next question comes from the line of Manav Gupta from UBS. Please go ahead.

Manav Gupta

Good morning. Can I get a little more details around this order with Element Resources for renewable green hydrogen, and then a little more details around the collaboration with GasLog LNG Services, I guess, both relate to hydrogen. So I'm assuming you could give us more details on those.

JillianEvanko

Yes. Thank you for the question. So let me -- well, first, what I would point out is we like -- those two are great examples of the breadth of the hydrogen being used in different applications, and then also different geographies. Element being further along in terms of their progress for the city of Lancaster, California. That project is liquefaction for their site in Lancaster, California. And just recently, I think last week, they announced the purchase of additional acreage and additional land for future expansion. So good traction there, and certainly, I think reflective of kind of how the U.S. hydrogen economy has started being specific to California, and now we're seeing that hub structure here in the future that's going to take similar opportunities around the United States. And then -- so future -- there is more future opportunity for us with Element Resources. And they're very disciplined and strong leadership in that business that has decades of both oil and molecule experience.

And then on the GasLog side, so this is earlier days, this does not have an order related to it yet. This is a partnership, and so ahead what we love, and we started hearing this at COP28 in December of '23, was that this large-scale infrastructure for liquid hydrogen is being focused in on and honed in on, whereas prior to that everybody was talking ammonia for marine, in particular. So this is around larger scale ship and marine transport with associated onshore infrastructure.

And the cool part -- I'll wrap my answer up, and the cool part I see, the thing I like about this, is this onshore infrastructure for heavy-duty transportation can work together across industries. And so while -- right now, we're having these studies and this work done with GasLog on the marine side as an example, or an Energy Observer on their infrastructure, or aerospace people on theirs, this is going to converge on itself and leave us with just an immense amount of future opportunity.

The other thing about GasLog that is specific to our partnership is again starting to see what was traditionally a very gaseous siloed hydrogen market in Europe, turn toward longer distances, heavier transportation, decarbonization, which is liquid.

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Operator

Thank you. And your last question comes from the line of Ati Modak from Goldman Sachs. Please go ahead.

Ati Modak

Hi, good morning, team.

JillianEvanko

Hey, Ati.

Ati Modak

Jill, you spoke a lot about carbon capture today, so keeping up with the theme, seems like Earthly Labs is getting a lot larger, which is great to see. But I initially thought SES was the driver in the quarter given its industrial scale. So curious on any color you can provide on that order in particular, and how close we are to increased commercialization and orders in SES going forward.

JillianEvanko

Yes. Thanks for the question, Ati, and good point. What we've done internally and haven't really shared the sausage making externally, but the Earthly and the SES teams work very closely together. So you see kind of Earthly scale up and SES's expertise at the larger end help them in their application. And SES gaining quite a bit of global traction. We did cite the Graymont agreement. There's numerous others that were not able to speak to publicly just under NDA of work that's being done. We're definitely seeing that in the UAE in particular, so good near-term opportunities there for SES. And the other kind of end market I'd point to for SES is on the lime cement side of things, really quite a bit of traction there toward commercialization.

So yeah, your point is extremely valid, right? Initially SES was for kind of -- this is going to be our large-scale. We've learned a lot about what end markets that have the money to do this and that it makes sense for them to do. And while we refer to Earthly and SES separately, it really is kind of one carbon capture solution that goes to different applications.

And maybe my last comment on SES/Earthly or our carbon capture end market, starting to see biogas also come into play there, which was a pull through from Howden's equipment and customer sets to pull our technology through. So that's getting some legs as well. We've had a few orders there.

Operator

Thank you. There are no further questions at this time. Ms. Evanko, please proceed.

End of Q&A

Jillian Evanko

Thank you very much and thank you to everyone for your time today. We look forward to providing updates as the quarter goes on and appreciate you attending our call this morning.

Thank you. Have a great day.

Operator

Thank you. That concludes our conference for today. Thank you all for participating. You may all disconnect.

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