

# **ElringKlinger AG (EGKLF) Q1 2024 Earnings Call Transcript**

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**Body**

ElringKlinger AG (EGKLF)

Q1 2024 Earnings Conference Call

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Company Participants

Thomas Jessulat - CEO

Conference Call Participants

Christoph Laskawi - Deutsche Bank

Marc Rene Tonn - Warburg Research

Michael Punzet - DZ Bank

Akshat Kacker - JPMorgan

Miro Zuzak - JMS Invest AG

Presentation

Operator

Ladies and gentlemen, I welcome you to our Earnings Call on the First Quarter of 2024. Today, I will provide a detailed look into the results from the first quarter and with today's publication, we confirm the guidance for 2024 in the midterm that we have published together with the annual report.

First of all, I already presented important elements of our strategy on the analyst conference in March. So you already know key ingredients. We have now unveiled the name, SHAPE30. We recently held an internal kickoff for the strategy and event for management within the ElringKlinger Group. In starting today's presentation, I will summarize the cornerstones of SHAPE30. Then I will discuss the financial figures in the first quarter and close with a few forward-looking comments on the remainder of fiscal year 2024. And at the end, as usual, you will have the opportunity to ask questions, and I am pleased to answer them.

To begin with, we are focused on two growth markets, which are the source for further successful development of ElringKlinger. Electrification of E-Mobility and the hydrogen economy are significant drivers within the new strategy. Nevertheless, we have a strong footprint on the ICE business. Our established position there is the backbone for our further transformation. In a nutshell, ICE business is our basis and the E-Mobility is our change in our future.

Our purpose is geared towards innovation. We will see ourselves in the center of innovation and our vision is to be the preferred partner in the market in new innovative technologies. The five success factors are the driving forces to shape the future of the group. These five success factors are the most important factors on the basis of which ElringKlinger will be successful in the future.

As such, we have identified sustainability, performance and process excellence, digital transformation and a modern corporate culture. The most important factor is the one listed here first, product transformation. It is the basis for the group's transformation. Let me elaborate on it briefly.

With a clear focus on innovative, value-creating products and a coherent strategic approach regarding markets, product groups and production allocation, we have a target of more than 50% of sales revenues in non-ICE applications by 2030. So the direction is clear. According to projections, battery and fuel cell elective regs will be the dominant drivetrain type by the end of the decade. However, the speed of transformation is expected to be different as shown on the charts.

In addition, the value chains are already different, and they're changing, and this implies different opportunities for automotive suppliers. The ElringKlinger Group is transforming successfully. Over the past three years, we have received nominations for non-ICE applications of more than €4 billion. Not all of this is published, but over the last few years, we have won contracts for a broad range of E-Mobility products across the group. Most noteworthy or high-volume contracts like cell contacting systems as well as bipolar plates.

However, it is the variety of products in which we received nominations that identify our product portfolio. Product diversification as well as customer diversification will contribute to a successful transformation of the group and as we will execute on nominations, the share of non-ICE revenues will increase and at the same time, the ICE revenue share are set to decline according to market estimations relative to non-ICE or E-Mobility.

We understand the ICE business is our strong backbone to financially support the scaling of the non-ICE business and as I said before, our target for 2030 is to generate more than 50% in non-ICE revenue on group level.

I come now to the financial figures of Q1 2024 and here, let me start with orders and sales. Order intake picked up again significantly in Q1, recording a volume of €489.4 million and therefore, we exceeded the substantial order intake of last year's Q1 by €14.5 million or 3.1%. Order backlog was up again quarter-on-quarter, coinciding with a strong order intake. It amounted to €1.33 billion in Q1 2024 and due to the return to more normal order intake levels over the course of 2023, the figure was down on the Q1 2023 level. And adjusted for currency effects, both order intake and order backlog would have been slightly higher.

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Coming to sales revenues, after a record sales level in Q1 2023, ElringKlinger generated revenues of €465.3 million in the first quarter. This revenue development is to be seen against the backdrop of challenging conditions for the market as a whole and according to industry service provider S&P Global Mobility, global automotive production declined by 0.8% in the first three months of 2024 and by as much minus 2.5% in Europe, the strongest market in terms of our revenue basis. Without currency effects, group revenue in the first quarter was behind the prior year figure by 3.8%.

Now we come to the sales mix. The ElringKlinger Group has a quite balanced sales distribution among business units, while the OE segment makes up the largest fraction of group sales revenues accounting in total for 73% of the group sales. In the first quarter, revenue changes and call off volumes from customers had an effect. In challenging market conditions, as outlined before, were evident in the OE segment business units.

On the other hand, the revenue of the E-Mobility business unit showed growth year-over-year with revenue from new series production orders in the area of battery technology also contributing to this. For the aftermarket segment, the growth strategy is taking effect. The segment saw a further increase in revenue compared to Q1 2023 and now makes up 19% of group sales.

On a regional basis, revenues in Q1 were generated mainly in Europe, accounting for 53% in sales in Germany and the rest of them together, followed by North America with a 26% share. Asia Pacific with 15% in South America and the rest of the world, representing 6%. The regional revenue dynamics roughly reflected the market developments.

Light vehicle production in the first quarter 2024 was globally down minus 0.8% in Europe minus 2.5%, as mentioned before, Asia Pacific minus 1%, while North America showed an increase by 1.4%. EBITDA remained comparatively robust at €50.8 million against the backdrop of the lower revenue level. Here, both sales mix and a better but still high level of commodity and material costs were supportive.

In terms of adjusted EBIT, the first quarter included minor restructuring-related and other nonoperating effects, €0.1 million each. And therefore, the group posted an adjusted EBIT of €24 million, which corresponds to an adjusted EBIT margin of 5.2%, which is close to the prior year level of 5.4% and as I have mentioned, better material cost development counteracted the lower sales. Energy and logistics were slightly better compared to Q1 2023 on a group level. Year-over-year, ramp-ups had a slightly better contribution from major contracts, among others, in the E-Mobility business unit. And because of a noticeably the better financial result and lower income tax expenses compared to the prior year Q1, the earnings attributable to our ElringKlinger shareholders increased to €13.3 million after €6.7 million a year earlier and earnings per share amounted to €0.21.

CapEx in Q1 reflects investments related to specific customer projects, including E-Mobility, for example. In the area of fuel cell technology, which means our JV subsidiary KPO investments were made in connection with a large-scale production order for bipolar plates, which is scheduled to ramp up from 2026 in addition to various development projects.

Within net working capital, inventories increased due to both work in progress and finished goods with the aim to meet all upcoming color volumes requested by customers as part of their ongoing scheduled arrangements. And trade receivables decreased year-on-year, while trade payables increased, leading to a decrease of net working capital by around 6% compared to March 31, 2023. And related to sales, the net working capital ratio improved by 1.2 percentage points to 26.8% compared to 28% one year earlier.

Operating free cash flow amounted to minus €5.8 million in the first quarter and this represents a significant improvement from the same quarter of the previous year despite a slight increase in capital expenditure and regarding financial leverage, the low level of net financial debt is on a stable footing.

Net debt amounted to €329 million at the end of the first quarter, significantly lower than the previous years. The net debt-to-EBITDA ratio stood at 1.7%, a visible improvement compared to 2.0 at the end of the first quarter of 2023.

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As I mentioned before, some changes in call of volumes from the customers had an effect on Q1 revenue. Overall, the OE segment generated sales of €340 million in the first quarter of 2024 and within this segment, we see overall strong ICE business as well as the ongoing ramp-ups in the E-Mobility business and if we all take together, the earnings contribution on the OE segment has been roughly neutral in the last quarters.

With its growth strategy taking effect in several regions, the aftermarket segment saw further increase in revenue compared to the same quarter of the previous year. Revenue amounted to €90.4 million in the first quarter of 2024, a year-on-year increase of €8.7 million and adjusted EBIT amount to around €23 million, corresponding to a margin of 25.1%. Revenue of the Engineered Plastics segment stood at €34.8 million in the first quarter and regarding segment earnings, a further increase in prices for high-performance plastics and higher expenses for R&D as part of the segment's transformation efforts weighed on the margin. Adjusted EBIT was €3.3 million after €5.1 million one year earlier.

Having said this, let me provide some remarks on the market in the current financial year. In the main automotive markets, the projections according to S&P Global Mobility imply flat developments in 2024, with growth of some 2% in China and North America, a decline of 2.2% in Europe. Global light vehicle production is expected in 90.3 million vehicles, a slightly better projection from S&P than we looked at two months ago.

Yes. And in this framework, we confirm the outlook for slight organic revenue growth in the fiscal year 2024. For the midterm, we expect that the transition to E-Mobility will contribute to further organic revenue growth through ramp-ups and the growth will be positive for the margin.

Regarding the other indicators, the 2024 and midterm outlook is confirmed as well. This year, we expect an adjusted EBIT margin of around 5%. Operating free cash flow for this year is expected at around 2% of group revenue and ROCE, return on capital employed at a value of around 6%.

Having said this, I'm very happy to answer your questions.

Question-and-Answer Session

Operator

[Operator Instructions] The first question is from Christoph Laskawi with Deutsche Bank. Please go ahead.

Christoph Laskawi

Good afternoon. Thank you for taking my questions. The first one would be on organic growth and the phasing of it. Obviously, you started slow versus the guide of slight organic growth, partially explained obviously because of high comps, which are easing only in the second half.

Could you comment, please, on how we should think about the phasing of organic growth into the second quarter and the second half of the year? Is it primarily H2 weighted? Or should we expect an improvement already with Q2? And then in the same context with regards to the outlook, you already started well in margin regards then or you currently loss making, obviously, with organic growth picking up, that should be improving as well. So should we think about the rest of the year as OE is improving and aftermarket slightly down from the currently very high levels? Or is there essentially nothing that should drive down aftermarket in the coming quarters?

Thomas Jessulat

Yes. Thank you for your question. The expectation here from the market is, as we all know, is sort of a flattish sideway movement yes. So when I look at OE sales and also, of course, aftermarket sales, then we had a very strong start into the year in the aftermarket and I would expect a sort of sideways movement here, right now going into Q2, maybe with a little bit of a weaker development, but slightly movements, if at all.

If we look at OE, then going into the second quarter and also the third and the fourth quarter, it's going to be a side-based movement here and there's essentially two areas where we expect some growth in this year. The one is aftermarket, of course, and we can see it and then on the other side, we have some ramp ups here on the E-Mobility projects that will contribute, but the question is whether that will overcompensate the general market development. So overall, sideways, I'd say, but no big surprises to the upside or downside as I believe.

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Christoph Laskawi

Thank you. As a follow-up to that, when you say sideways, does it mean in absolute levels from where we currently are in Q1 or in terms of year-over-year revenue growth?

Thomas Jessulat

I think more in terms of year-over-year, yes. But when you say in absolute terms, there is some weakness in the market, sideways, slight growth. So in absolute terms, slight growth, a couple of million on a quarterly basis, eventually.

Christoph Laskawi

And just on the margin question on aftermarket and...

Thomas Jessulat

I think that it's going to be corresponding -- if we have we had a very strong start. From a margin perspective, expectation is we are going to be in the area of what we have seen, yes. I don't see any reason to be having short-term changes to it, but again, we had a very good start.

Operator

The next question is from Marc Rene Tonn with Warburg Research. Please go ahead.

Marc Rene Tonn

Good afternoon, and thank you for taking my question. Also with regard to phasing of profitability and you mentioned the ramp-up charges compared to the previous year in the first quarter being slightly supportive, but your view on -- and I think this better-fee connector contracts ramping up in the second half year, do we expect a significantly higher ramp-up costs year-over-year in the second half? Or has there been, let's say, ramp up in last year already, which also lead to some kind of a sideway development here as well?

And secondly, perhaps, now it more long term is probably kind of transitory particularly when it comes to the margin, where profitability tends to stick around, let's say, breakeven level probably for the remainder of this year. How would you expect that to increase from here, which would be, let's say, significant? Do you need much more sales growth? Is it already next year with, let's say, better revenue contribution from new contracts supporting sales, when and which magnitude should we expect profitability in this segment to pick up? Thank you.

Thomas Jessulat

Yes. Thank you for your question. I would not expect a significant development on the downside in terms of our ramp-up cost in the negative EBIT contribution here from the start-up business units, but what we see in inventory, we see here not only, of course, a higher inventory level compared to the previous year's here in aftermarket, but we see also more activity in terms of tooling and development, capitalized development costs that will be charged to the customers, yes.

So what I'm saying is there is more activity that we see here also in the balance sheet in terms of ramp-up activity. I would expect the same level of cost going forward for the foreseeable future, but we see some elements also in terms of some items that will be sold to customers. And overall, again, sideways movement here this year. Next year, expectation is there's more sales growth and more contribution margin coming in from those starting projects.

Marc Rene Tonn

And just as a follow-up. We're all talking about less that kind of tactical shift to see a bit less demand for EVs currently, a bit more for from ICE. So if you expect this here to be, let's say, around breakeven for original equipment also that they no major support to your bottom line on a mix shift more to the presumably more profitable ICE component that we should expect.

Thomas Jessulat

There is going to be an effect on that. I think that as well. Overall, will we see it, I think it will be a balanced effect, but there is more demand on ICE products, which is helping, of course, but overall, I think it's going to be neutral.

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Operator

The next question is from the line of Michael Punzet with DZ Bank. Please go ahead.

Michael Punzet

I have two questions. First one is you mentioned, let's see some lower call-offs for your customers. Have you had any indications that this will pick up in the second quarter and especially in the second half and the second question is on E-Mobility. I would assume that you are still loss-making when we should expect a breakeven in E-Mobility.

Thomas Jessulat

Yes. Thank you for your question. On the lower call-offs, is there going to be a pickup expected? I think this is a product mix related question. There is going to be the development in the second half later in some areas, but is that associated with a short-term pickup that I would expect now.

On the E-Mobility side, there's two main areas here. Of course, there's EKPO there's fuel cell activity and the fuel cell market, of course, is going to be trailing the battery market. So when I look forward and I look at our revenue side, then I would see towards 26-ish plus/minus a year. I think a more neutral situation here breakeven situation for battery, but not yet at the fuel cell business unit and therefore, overall, when we take all of it together, it's going to be in the later part of the 20s where we will eventually see a breakeven situation, yes.

Michael Punzet

So for battery E-Mobility, you would expect, let's say, 2 weeks breakeven '26, '27.

Thomas Jessulat

26-ish I think so.

Operator

Next question is from Akshat Kacker with JPMorgan. Please go ahead.

Akshat Kacker

Three from my side as well please. The first one, just on inflation; could you just talk about your expectations for the full year in 2024, gross headwinds probably across labor, logistics, freight, but also tailwinds across raw materials and energy and how do both these buckets pan out? That's the first question.

The second one, again, on E-Mobility losses, but specifically on 2024, could you just tell us directionally are those E-Mobility losses expanding in 2024? Or are they coming down? That would be helpful as well and the last one on the auto OE margin. I think with the full year results, you did mention that the next step of the business is to achieve 1% to 2% margin. Is that something that you still plan on achieving in 2025? And how should we think about the step to the 1% to 2% margins. Could it be loss-making this year? Thank you so much.

Thomas Jessulat

Yes. Thank you for your questions. In regard to inflation, it's exactly like you're saying. It's not only easing in the material area. Nevertheless, we see in some commodities that we manufacture, we see slight increases and sometimes also higher increases. So I would not say the material side is very much relaxed because we see upticks and in some areas, again, strong upticks. Definitely, labor inflation is a global matter, and this is exactly the point that makes life in 2024, more difficult because there is less a contribution here from revenue sales revenue growth.

On the E-Mo losses would be expanding in 2024 or if losses are expanding in 2024; no. I think -- and this is what I tried to say before now, there is more activity in terms of selling engineering costs and engineering items and tooling items. So the customer, there is more activity coming from the startup of new projects in the upcoming quarters, and I would not expect here that the loss-making situation is going to be widened. I don't think so.

And of course, in terms of auto OE margin, we work very hard on the improvement here. Right now, we are slightly negative here on OE segment, but we have a lot of activity in regard to that because that is our main point to address that, that we will be able to achieve a 1% later than the 2% margin on OE. Part of it is activity in regard to optimization here in the group and part of that, of course, is associated with the revenue cycle of the new businesses...

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Operator

Next question is from Miro Zuzak with JMS Invest AG. Please go ahead.

Miro Zuzak

Hi Thomas. Thank you for taking my question. Could you please give us a two to three year outlook for the fuel cell stack business in terms of revenue development that you expect?

Thomas Jessulat

Yes, when we look a little bit into the future, we'll see at the end of the period, the 2 to 3 period that you mentioned, we'll see the start of the contracted series production of bipolar plants in that time frame. That is going to be starting exactly at that point in time. Right now, there is some activity and also contracted business on bipolar plates for electrolyzer systems.

My expectation is that, that part of the business is going to be picking up. We have received first orders and I would expect that we are here also having a good contribution from that side of the business. And if you look at our stacks from NM5 to NM12 twin expectation here is that we are more and more going into a little bit larger small series sales. And overall, then growing the business in terms of the relative low levels that we have today.

Miro Zuzak

Can you please differentiate there's, I think, a large contract from Audi over 9 years, like EUR 50 million per annum. When does this one start? And then also basically within the Plastic Omnium joint venture, basically, it was once mentioned, not by you, but by your predecessor that this would be breakeven at EUR 150 million in sales. Could you give us an idea when we will reach the EUR 150 million in sales if we are there already?

Thomas Jessulat

Yes. Let me say in regard to specific customers. In some areas, we can talk about them in some areas, we can't. This is definitely an area where I cannot talk about what customer that is, and I apologize for that. But here, we have contractual situations that are not putting us into the situation where we can be more specific here.

When we talk about a level of €150 million sales, my expectation is that we will see those levels in a three year to four year time frame, yes. Because, like I said, when we look at the mass production here, the start of mass production for bipolar plates for a large customer, this is going to be starting at the end of the two year to three year period.

And then, of course, it depends on the level of support from electrolyzer business as well as the stack business. But my expectation is 4 to 5 years is a reasonable area where we can think about that. But until then, our expectation here is markets will be developing, yes. And we'll see a lot of activity here in different products that we have and that we offer to the market, but it's more like smaller production lots, yes.

Thomas Jessulat

Yes. Thank you all for your participation. For your information, the next important dates are the Annual General Meeting on May 16 and our Q2 call on August 07. Wish you all the best. Thanks for listening, and bye-bye.

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