

# **ElringKlinger AG (EGKLF) Q2 2024 Earnings Call Transcript**

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**Body**

ElringKlinger AG (EGKLF)

Q2 2024 Earnings Conference Call

August 7, 2024 8:00 AM ET

Company Participants

Thomas Jessulat – Chief Executive Officer

Conference Call Participants

Michael Punzet – DZ Bank

Akshat Kacker – JPMorgan

Presentation

Thomas Jessulat

Yes. Ladies and gentlemen, welcome you to our Earnings Call on the Second Quarter of 2024. Today, I will provide a detailed look into the results from the second quarter. First, I will briefly highlight some key developments from the first six months of 2024, also relating to SHAPE30, our transformation strategy. Then I will present and discuss the financial figures of the second quarter and close with some comments on the remainder of the fiscal year 2024. At the end, as usual, you will have the opportunity to ask questions, and I'm pleased to answer them.

To begin with, one highlight is definitely our new transformation strategy, SHAPE30. We published this strategy in the first half of 2024, and its implementation is currently in full swing. I'll get to that in a moment.

In the fuel cell business, our technology once more proved high-performance and wide application scope. EKPO will supply fuel cell stacks for the first non-stop hydrogen flight around the world. Also aviation, but on the ground, EKPO supplies a stack for power supply unit at the Amsterdam Airport. In addition, EKPO and the Chinese FAW Group have signed a contract on the development and delivery of fuel cell stack model prototypes for being used in a next-generation fuel cell vehicle of FAW's premium brand, Hongqi.

We also achieved significant progress in battery technology over the past couple of months. In April, we performed a symbolic groundbreaking ceremony for the construction of the new logistics center at the Neuffen site together with Minister-President Kretschmann, the Prime Minister of the State of Baden-Württemberg. We are expanding the current production area by around 4,500 square meters, and we are increasing capacity in Neuffen for battery production line and logistics.

As a result, Neuffen will be prepared for large-scale production of battery components, modules as well as systems. And we further expand the battery business by establishing our new battery center in the United States. Located in Easley, South Carolina, the new facility will manufacture battery products. We plan to develop the site into a battery hub for the activities on the American market. Operations in South Carolina are scheduled to start in mid-2025. The 2024 AGM approved the dividend of €0.15 with a large majority. And since May 2016, Helmut Merch as new Chairman of the Supervisory Board of ElringKlinger AG.

And last but not least, on the financials, in the first six months of 2024, the automotive market environment has not been very supportive on growth. Sales revenues in the first half came in at €910 million, which is below prior level. Adjusted EBIT margin was 5% in Q2 and 5.1% in the first six months and therefore, on track for the full year guidance. I will elaborate on the group financials just in a moment.

Yes. Ladies and gentlemen, as you can see, the transformation of ElringKlinger Group is progressing well on the back of our strategy, SHAPE30. Let me briefly comment on the success factors of SHAPE30.

As presented in March, the five success factors are key for our transformation and are the basis for being successful in the future. The first one is product transformation. ElringKlinger was in the midst of transformation and transformation is in full swing. Already today, ElringKlinger has received a significant nomination volume for known ICE applications including nominations for products across the transformation portfolio.

On the basis of a comprehensive market analysis, the ElringKlinger product portfolio is being assessed and dependent on this and on our nominations, we constantly examine our current setup how best to meet customer requirements. And as we go deeper into transformation, we will implement further steps and measures on the way to meet our midterm targets.

As you all know, steps like the termination of production at one of the German sites as well as the discontinuation of business activities and the area of engine testing services have already been realized. All other success factors under management focus in terms of increasing competitiveness of the ElringKlinger Group in the future.

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I come now to the financial figures of Q2 2024, starting with orders and sales on Slide number 5. Order intake in the second quarter of 2024 amounted to €364.9 million. We see a mixed picture across the group. In summary, Europe is somewhat weaker compared to last year's period. Currency headwinds influenced the 2024 figure as well, assuming stable exchange rates, order intake increased by 1.4%.

Order backlog at June 30, 2024, which comprises customers aggregated and as yet unrealized short-term call-offs stood at €1.25 billion. Like I have stated this year, the figure was down on the prior year due to product mix and project call-offs for electric vehicles and also in the commercial vehicle sector.

Sales revenues saw a year-on-year decline by 5.1% amid challenging market conditions. And after a record Q2 performance in 2023, the group generated revenues of €445 million in the second quarter of 2024. In addition to currency effects, changes in customer call-off volumes related to individual series production projects for electric vehicles and in the commercial vehicle sector impacted Q2 sales. Without currency effects, revenue was behind the prior year figure by 3.8%.

Coming now to the sales mix on Slide number 6. The group has a balanced distribution of sales among the business units, while the Original Equipment segment makes up 74% of group sales total. In the second quarter, revenue of the originally classical business units decreased year-on-year, reflecting the challenging market conditions. In contrast, sales of the E-Mobility business unit developed well with project ramp-ups contributing to revenue, which stood at €17.7 million in Q2 after €10.9 million one year ago. Also, the Aftermarket segment developed favorably. Its growth strategy is taking further effect. Aftermarket revenue was up 12% to €84.8 million. And by this, the sales mix supports group earnings.

I already mentioned a challenging market environment in the key automotive regions. According to the latest data of S&P Global Mobility, light vehicle production in Europe contracted by 6.1% in the second quarter of 2024. Taking Germany and the rest of Europe together, sales were €240.1 million, almost reaching the prior year Q2 figure of €240.7 million. Adjusted for currency effects, revenue in ElringKlinger's largest geographical region were even up 1.3%. In North America, the group generated sales of €113.8 million, after €119.9 million one year earlier, a trend already seen in Q1, while in the Asia Pacific region, revenues stood at €65.5 million.

I come now to Slide number 7. Despite the decrease in revenue in Q2, EBITDA was robust and increased to €49.7 million. In terms of adjusted EBIT adjustments were minor in Q2 2024, while the previous year's Q2 included non-recurring effects totaling €8.1 million related to, among other things, the discontinuation of engine testing services and as well the termination of the CEO's contract.

Adjusted EBIT stood at €22.5 million in the second quarter, resulting in a margin of 5%. Compared to the prior year Q2, the lower contribution margins due to the decline in revenue on the one hand contrasted with lower expenses for certain key raw materials as well as for energy and logistics on the other hand. In the first half, adjusted EBIT stood at €46.5 million with a margin of 5.1%, which is well on track for achieving full year guidance.

Due to lower income tax expenses compared to 2023, the earnings attributable to ElringKlinger's shareholders' increased to €23.2 million in the first half. And as a result, earnings per share amounted to €0.37 in the first six months of 2024, well in excess of the prior year figure of €0.14.

CapEx in the second quarter related to expansion and alignment of production activities to support our strategic goal of transforming the ElringKlinger's group's portfolio, including investments in battery and fuel cell technology. Within networking cable inventories slightly increased in Q2 because of ramp-ups and tooling, while receivables decreased and payables expanded. In relation to group sales, the net working capital ratio improved by 1.2 percentage points to 26.8%, which compares to 28% in Q2 2023.

Operating free cash flow generally follows the same pattern as in the prior years. And the first half of 2024 was better than the prior year figure of minus €16.5 million, and now amounted to minus €10.3 million. And this is mainly due to cash positive influence of working capital. In Q2 2024, it amounted to minus €4.5 million after €3.7 million in the same period one year ago.

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And regarding to the financial leverage, the net financial debt level remains on a stable footing with less financial liabilities, net debt amounted to €350.4 million as of June 30, 2024, visibly lower than the Q2 2023 figure. The net debt-to-EBITDA ratio was 1.7%, also an improvement to the 1.9% one year earlier.

Coming to segment performance on Slide 9. Overall, the OE segment generated sales of €328.3 million in the second quarter of 2024. Within this segment, we continue to see overall the basis of ICE business as well as the ongoing ramp-ups in the E-Mobility business unit as well as the mentioned impact of changes in customer call-offs related to electric vehicles and the commercial vehicle sector. The adjusted EBIT margin of the OE segment continues to contribute roughly neutral to group earnings. The Aftermarket segment successfully implements its growth strategy and saw a further increase in revenue.

Sales amounted to €84.8 million in the second quarter, and adjusted EBIT amounted to €20.5 million corresponding to a margin of 24.2%. Revenue of the Engineered Plastics segment stood at €31.5 million in Q2. In regard to segment earnings, slightly higher personnel costs as part of the segment's transformation contrasted with an improved material expense ratio due to a slight year-on-year decline in prices for High Performance Plastics. Adjusted segment EBIT improved from €2.5 million to €2.7 million in Q2, which corresponds to a margin of 8.6%.

Yes, let me now provide some remarks on markets in the remainder of fiscal year 2024. There is a mixed picture for the projections of the main automotive markets. According to S&P Global Mobility, the third quarter of 2024 is expected to be globally weak, while the fourth quarter will see a sequential improvement, at least in North America and in China. And let me add regarding the different powertrains. The production of electric and fuel cell vehicles is expected to increase by double-digit growth rates in all three main regions in the second half of 2024 compared to the same period last year.

Coming now to Slide number 12, the outlook. Generally speaking, business conditions in the industry remain challenging. In addition to geopolitical tensions, including trade policies like customs, barriers this is also attributable to macro developments such as inflation and economic growth as well as the mentioned industry-specific factors such as decline in demand for EVs and the debate in Europe by lifting the bans imposed on combustion engines. We have a strong footprint in the ICE business and our established position in ICE serves as the backbone for our ElringKlinger transformation.

On the basis of half year figures and the expectations for the second half of 2024, we confirm the outlook for slight organic revenue growth in fiscal year 2024. Against the background of a challenging market environment, the group assumes that the new series orders for electric vehicles will ramp up and that the general forecast for LV production and commercial vehicles will not be revised significantly further. Actually, according to S&P, battery electric and fuel cell vehicles are expected to grow significantly at double-digit rates in H2 2024. And at the same time, positive impetus is expected from commercial vehicles, which should have a stronger year-on-year development in the second half of 2024 compared to the first six months compared to the first half of 2023.

In summary, there are risks and chances that we see for the second half of the year. 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 at a value of around 6%. And regarding the other indicators the 2024 and midterm outlook is confirmed as well.

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

Question-and-Answer Session

Operator

Our first question today is from Michael Punzet [DZ Bank]. Please go ahead with your question.

Michael Punzet

Yes, Michael Punzet. Good afternoon. I have two, let's say, three questions. First two are on the aftermarket business. What are your expectations? How long is the outstanding margin of more than 20% last? And what is the sustainable level we should expect for the coming years? And the last one is on your midterm guidance. Can you please quantify your midterm target? Is that three years to five years so that we should think about 2029, 2030 with 7% or – maybe you can elaborate a bit on that?

Thomas Jessulat

Yes. Thank you for your question. The midterm is three years to five years. And this is the area in which we want to achieve here the KPIs that we have put into this forecast. From an aftermarket perspective, on the one side, there's certainly some momentum in terms of a good development here margin-wise and it's a very good situation here. We expect going forward higher levels of sales still, but we will also have to add capacity into, for example, logistics and in some of the overhead. So therefore, we expect a high margin in the area of what you have seen, but we will also see some fluctuation there, but on a high-level basis in terms of what we expect here.

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Michael Punzet

Maybe a follow-up on that. I think in one of the last calls, you said that you expect margin to go to stabilize at this level. So do you still expect that we just that you will achieve margins of more than 20% in coming years? Or will we see a normalization, let's say, in the range of 15% to 20%, which I think is more realistic compared with the figures some years ago?

Thomas Jessulat

Yes. The expectation here based on operating leverage, based on further growth here is that we are somewhere around 20%. This is the expectation, but there might be step-up costs along the way, which could have an impact from a short-term impact. But as we grow further, we'll see some effects here also coming from operating leverage yes.

Michael Punzet

Okay. Thank you.

Thomas Jessulat

Thank you.

Operator

Our next question is from Akshat Kacker from JPMorgan. Please go ahead with your question.

Akshat Kacker

Good afternoon, Mr. Jessulat. Two questions, please. The first one on the E-Mobility business. Could you just remind us of your expectations on E-Mobility revenues going into the second half versus the first half of this year. And when you look at your order backlog and what Europe needs to achieve to meet CO2 targets going into next year, how would that help your E-Mobility business going into 2025, please?

The second question is kind of linked to that. How should we think about the auto OE profitability based on all the ramp-ups that you're seeing in E-Mobility and how should that progress going into the second half as well as 2025? I'm sorry, I would sneak in another one. The third one is on CapEx. It did pick up sequentially in Q2 versus Q1. Have your expectations for the full year CapEx changed in any way? Thank you so much.

Thomas Jessulat

Yes. Akshat, thank you for your questions. On the first one, the expectation that we had for one particular project that we have now in the run-up here was the very low 3-digit million [ph] euro amount for the year. But we have seen delays here. We are now ramping up, but we won't see that amount. Now we will be a little bit lower, I guess, a little bit lower than half of that amount, yes. But that means that going forward, for next year, expectation is that at least from that ramp up, we'll see something like a high double-digit sales figure in €1 million. That is going to be helping us to work through the ramp-up curve.

And on the other side, of course, we are working on additional battery projects that give us also some, let's say, additional expenses along this production starts. So what does it mean? We will see, I think, to some extent, a continuation in the battery business here that is negative for the foreseeable future. And for battery, I said 2006 plus minus one. This is expectation here that we are getting closer to a breakeven situation.

Now the CapEx pickup in Q2, what you have said is related to that, that step-by-step, we are adding capacity here to the group, in particular, on battery, but not only we are also – as you know, we are having an order here for bipolar plate. There is also some capacity that we are building up in the fuel cell area. Those are the two key points, and we'll see more investment here directed to those projects, but I won't see any change in terms of the full year guidance that I have given. And we are going to be the 4% to 6% is something that we have said. And along the line in somewhere in that area, we'll find ourselves as well for 2024, yes?

And to your second question, now auto OE profitability, we are working hard on an improvement here in this area. This is the largest segment that we have. And in this segment, we see our fuel cell business. We see the battery business. And we see, of course, the established business. And what we do here, we work on optimization and improvements here in our existing footprint, which is an important part in terms of what we do and what we will do going forward to reach improvements here. Then we'll see some operating leverage along the line from coming out of battery and fuel cell will continue for the foreseeable future. That means to some things up, the expectation is that step-by-step, will reach a better situation in terms of OE margin, but we'll have to continue to work through our plan here in order to reach that target.

For 2025, there is a detailed plan that we are following up with and towards 2026 expectation would be that we will have a lot of the plan finalized and completed and to be in a different situation compared to what you have seen in the OE segment in the past.

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Akshat Kacker

Thank you so much for the details. One quick follow-up. As you mentioned and you take multiple steps to work on the – OE profitability as well as you've defined the SHAPE30 program. In terms of all the cost actions of course restructuring that would imply, have you laid out any guidance in terms of the cash restructuring needs in the business, please? Thank you.

Thomas Jessulat

No. At this point, I haven't. There is nothing that I have given in regard to that.

Akshat Kacker

Got it. Thank you.

Thomas Jessulat

Okay, thank you for your questions.

Operator

It seems to be no further questions at the moment, and I will hand back to Mr. Jessulat for any closing comments.

Thomas Jessulat

Yes. I would like to thank you all for listening up in our call here and wish you all the best for the holiday season, which is upcoming. And don't forget, Q3 release will be taking place on November 12. Thank you very much. Best wishes to all of you. Bye-bye.

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