

# **ElringKlinger AG (EGKLF) Q4 2023 Earnings Call Transcript**

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**Body**

ElringKlinger AG (EGKLF)

Q4 2023 Results Conference Call

March 27, 2024 08:00 AM ET

Company Participants

Thomas Jessulat - Chief Executive Officer

Conference Call Participants

Frank Biller - LBBW

Presentation

Operator

Ladies and gentlemen, welcome to the ElringKlinger Group Analyst Conference Full Year 2023. I am George, the Chorus Call operator. After the presentation by Mr. Thomas Jessulat, CEO, there will be a question-and-answer session with participants who are present with us here in Frankfurt. I would like to remind you that all participants will be listen-only mode and the conference is being recorded. [Operator Instructions].

The conference must not be recorded for publication or broadcast. At this time, it's my pleasure to hand over to Thomas Jessulat. Please go ahead.

Thomas Jessulat

Ladies and gentlemen, I would welcome you to this year's analyst conference here in Frankfurt on May 27, 2024. We have quite some news and new information and new developments coming out of the fiscal year 2023. And I start with the nominations that we have received, significant nominations in regard to a different set of products. I start with a large-scale nomination from BMW Group for the supply of a cell contacting system. APO has received orders in regard to electrolysis products and also, we have received different other nominations here for metal housing components here and you see it here in the middle top as part of the new positioning of metal forming and assembly technology.

Further, in November last year, we have received IPCEI funding and this is a European support scheme for the development of the hydrogen up to €177 million in regard to further development of a fuel cell stack for heavy-duty applications. And we have driven forward as well our new location here in Neuffen, our battery technology competence center where we will introduce and industrialize new products and where we will expand this facility, so that it is able to have and to implement those new projects.

I'm here in my new function as a CEO and I can also announce that Dirk Willers has been appointed as per Q4 as per 1 October 2023, our CSO, Chief Sales Officer and Dirk Willers is still in this function today, Head of Business Unit Aftermarket. And you have seen the great success of this segment here and we're really happy to have him on Board of the Board of ElringKlinger in order to drive sales of the group.

We at ElringKlinger, we have looked at ourselves and we have developed and refined our purpose, the vision and the mission. And this defines where we see ourselves in terms of where we want to be in the market. One is clear and you see this in a purpose, pioneering innovative technologies for a sustainable future that means that we will further see ourselves in the center of innovation.

Technology, new technologies is something that we will embark on and this would be the center of our existence. In the marketplace with our customers, what do we want to be? We want to be a preferred partner for our solutions in the new innovative technologies. And I think both set the tone in terms of we will continue to invest in innovation and we will continue to be early in new technologies like we have done for example in the hydrogen business with fuel cells, bipolar plates where ElringKlinger has been active for more than 15 years now. So, the mission, I'll get to that in a minute.

There is two markets that we see as a source of further growth for the group. And the one is, of course, e-mobility. And e-mobility gives us with new products big chances to further grow the business and to introduce new products to the market that are based on capabilities that the company has as of today. We'll see that when we look at the middle of the bottom here in 2030 that the expectation is with BEVs and fuel cell vehicles we have an amount of 46 million vehicles being produced relative to 11.7 million worldwide. Then there is huge potential for us to engage in this market and to continue, of course, our place here in terms of the drivetrain of a vehicle but now in a new technology sector.

And the second is the hydrogen economy. This is the second market that is really important to us and it enables us to develop new products. If you talk about sealing products, if you talk about bipolar blades, fuel cells, potentials for fuel cell or electrolysis, there is a huge development going on over the next decade and more and we see on the right side a big expectation here in the generation of hydrogen. We see a huge chance here. So, it's not only what you see here on to my right side the fuel cell which is the use of hydrogen to turn that into electric power, but we also want to participate in the generation of hydrogen and we have a lot of products that play a good role in this regard.

And here on the left side, of course, is what you see here as well in terms of upfront there bipolar plate or here a fuel cell system. This is the NM12 that you see here a system that generates 100 kilowatt hours to 150 kilowatt hours and this is something that we have been developing, and we are in the process of selling that product into the market. Yes, those are the two significant drivers for growth at ElringKlinger. And let me show you what we have identified at ElringKlinger in terms of what we see as the most important factors that ElringKlinger will be successful in the future.

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Number one here on the very left side, of course, is the product transformation. It's a transformation away from products for internal combustion engines. We are staying in this market. We will participate here for the next decade in Europe in this market. But of course, we have to transform and we have to come up with new products for other markets. This is very important and without number one, there is little of number two to five.

Number two, of course, on the one side driven by legislation, but also driven by the values that ElringKlinger's sustainability, where we are very active and I'll get to that in a minute, performance, process excellence, digital transformation to transform the business also into a digitally updated or engaged enterprise and not to forget to change and to further develop the corporate culture that fosters innovation.

So, if we focus here on the success factor number one, this is the product transformation then we have the target that by 2020 by 2030 more than 50% of revenues shall be in e-mobility or non-ICE applications. And when we further drill into the segments here, then we have, of course, the original equipment segment. And the original equipment incorporates our classic product fields as well as the new product fields and the product fields with e-mobility business units. Both is in here and I'll explain a little bit more afterwards.

Aftermarket, we have a very strong cycle in aftermarket right now. We have an outstanding situation here in terms of market share in different regions of the world and we are in the process of globalizing this business into the U.S. and also into China. And you will see here based on our 2023 figures that we are really successful in doing that.

And of course, we have the segment for Engineered Plastics that serves different industries with different kind of products and where we see also a lot of potential for those new markets. So, if we further drive down into the OE segment and the OE segment is comprised of 76% of group revenues. And here we are in 2023 at €1.412 billion in revenues with more or less neutral results.

Why is that? Because on the one side we have very profitable business, of course, in the classic area. But on the other side, we have in this segment also all the developments here for battery, for fuel cell and for electric drives. And this is essentially the reason why as a net figure this has more or less a neutral result. And when we try to understand how is transformation done at ElringKlinger, when we see here on the left side the classical business units are a source of innovation because based on their process capabilities, they, on the one side, maximize value and generate cash by executing on a cash focused basis the classical products, but on the other side, they also develop new products for e-mobility applications, which you see here on the bottom right.

And then, of course, we have the new business units and this is battery, fuel cell and drivetrain where we have new developments for totally new products, but also based on processes that, of course, we have already in the group. So, we take a look at that. This would be the picture that is associated with that.

Here in the middle ICE components and e-mobility applications, and you see here our cylinder gasket shielding system, lightweight elastomer products for ICE applications and ICE and there's no doubt about that will carry us for a long time and will provide us with the funds needed for transformation. But on the other side, they are also developing and selling products for battery applications, underbody applications and you'll see here some of those product groups in this room and also cell contact systems as well as fuel cell applications here from our e-mobility business. And Engineered Plastics, same. So, we see here a very diverse picture of the development in terms of the transformation. And in order to better understand that and I'm not sure whether this picture is really easy to understand, but I'll try to explain.

We see here the OE segment and the OE segment is comprised of ICE components and ICE business that, of course, represents the most of our sales share, as I explained. We see in green here e-mobility. Y axis is the cash flow in the group in this segment and here on the x axis it's the portfolio. And in order to understand how we approach this transformation, we see that over time ICE is expected to decline as we all know. ICE applications in particular in Europe and also in other regions. In other regions of the world, ICE is going to be a higher share of the business. Let's don't forget that. But it's generating cash flows. It's generating EBIT, and we are in a good situation because we have high market share in that area.

Then when we look at e-mobility, you see that the cash share of that is negative because we invest significantly in transformation and those business units. Therefore, we have a negative cash contribution here. And on the right side, we have also part of the portfolio that we say it's not core. It's non-core business. And some of it we have executed already, some of it we have not executed already.

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So, there is limitations that we see in regard to future profitability or cash generation that is not playing a role on the left side. That at some point is going to be discontinued. So, when we look at the OE segment going forward, we see that we have to discontinue operations that don't make any sense for us. You see that e-mobility we need to come into the cycle where we generate revenues, contribution margins and improve cash generation here. And then at some point in time, the e-mobility area will contribute earnings and cash and we are back in a normal situation, let's say, where we don't have to invest anymore upfront into e-mobility. And this is essentially not an easy picture, but this is the best way we found to explain the situation in OE segment. And it's important that this is the way we think about this.

So, when we look at the classical business units and ICE revenue is around €960 million. Again, we have strong market positions. We have seen that we could in fact implement pricing in the cycle that was not an easy one so that we could maintain EBIT margin in the group under really difficult circumstances. And we could see that in 2023 that strong market position has helped us.

When we look at non-ICE revenue now as this is part of the OE segment. We see here the non-ICE revenues in 2023, €214 million in sales. And it's not saying much. Therefore, what we have done here on the top right, we have put here the 2023 figures that we report as part of EU taxonomy. And EU taxonomy that gives us on three categories information in terms of eligible activities in the amount and as a percentage of the total amount.

And you see here while in 2023 eligible activity in regard to sales is €7.4 million and it's not much because we are really at the beginning of the cycle we have to say. But when you look at CapEx, we have €58.6 million CapEx that goes that is eligible and goes into new technologies. And this is a good insight information where we can use EU taxonomy a little bit to explain more what we've done and also when you look at 2023 relative to 2022, there's an increase of 54.5%.

That means that we are given the figures that we have seen, we are in a very strong investment cycle here goes into CapEx, but also goes into operational expenditures, OpEx with €25.2 million and this is also an increase of 11.3% relative to 2022. And that gives a little bit of information how strong the internal focus and the funds the way we direct that into the transformation story is given the figures that we have seen here in our annual statements.

Again, here on the bottom, more than 50% of group revenue shall be part of non-ICE by 2030. So how is the way going? We have a lot of knowhow at ElringKlinger in terms of material, in terms of process. And if you look here in the middle, we have coating, stamping, embossing, injection molding, metal forming and this is all the capabilities that we have in ICE that we apply now to e-mobility. And you see as an outcome the different products that we have generated and developed from that. Because we see here on the top left, we see fuel cell applications, electrolysis applications, battery cell contacting system, rotating parts, rotor stator applications for energy efficient e-motors.

In terms of injection molding, underbody protection for battery systems, gasket applications for EDUs, battery systems, lightweight, of course, is part of our focus here as well. And in terms of metal forming, we have a lot of metal applications in the market for battery housings. Now ElringKlinger could do metal or could do plastic. And it all depends on what really the customer needs. So, we have really a nice set of products here that go into all sorts of different applications at our customers. And here you see the four key areas. Here like I mentioned on the left fuel cell battery, drive chain, Lightweighting metal forming and the outcome of that. And here 2023 was a huge year for ElringKlinger, because we have received here orders for cell contacting systems from different customers. One to mention is BMW with a new class.

We have received orders for bipolar plates for fuel cells as well as for electrolysis applications at EKPO. We have received orders for battery housing parts based on metal applications, several one and we have received a lot of stack orders for prototype and small series production. That means that 2023 is the change year for ElringKlinger because this shows that the plan that we have and we said always we wanted to go towards €3 billion in sales, but of course, we had a lot of discussions also in regard to, okay, where are the orders and how much do you have on order. And by now, ring finger has received for e-mobility applications and this is not all published more than €4 billion and you see here on the right side with how many different types of parts in different type of applications. The most noteworthy, of course, is cell contacting systems where we have received really significant amounts.

But as I always say, yes, in the inside and the outside, the key point and the key play for ElringKlinger is the customer diversification and the product diversification. And therefore, the size of the order is not the point that we want to make. It's the variety of products that we have received nominations. And here again, we are on a very good way to a growth path by those nominations that we all have received in 2023 and also some beginning of 2024.

So, you see here on the very right side what I mentioned, that target is more than 50% non-ICE application and we have business plans for the individual units that you see here on the very left. That during a slow expected decline for ICE applications that we have an overcompensation of the decline in terms of growth. And this is something where I always said we have a lot of positive potential here in regard to that. And it seems like that now we see and we realize the potential that ElringKlinger has.

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Now when we look at the aftermarket segment and you see here in the middle the revenue development, while in 2020 we had €182 million in sales, by 2023 now we have €300 million, and only relative to 2022, we have a €0.196 increase in terms of sales. There's a lot of increase we have to say when you look at the balance sheet in terms of inventory. And this is because of globalization to a large extent of the aftermarket in the different regions where we have to have products available on the ground. This is part of that and this is the basis for the growth that we have seen here. And if we see EBIT adjusted then we come from €50 million to €72 million and this is an increase of 42.8%.

Of course, aftermarket is helping us here to fund this transformation, but it shows also in what strong position ElringKlinger here has and we expect further growth going forward. And when we look at Engineered Plastics segment, we have pretty much a flat development between 2022 and 2023. There's different segments in the market we serve here. Some markets that we serve are pretty flat and therefore that is not so much a participation in growth, but still nonetheless we have a €17 million EBIT adjusted contribution here coming out of that segment.

Now we come to success factor number two, sustainability. And the target that we have from a very outside approach is to be CO2 neutral net terms by 2030 in regard to Scope 1 and Scope 2 emissions. But we also focus within this area of activity on the employee's engagement. We try to motivate and bring onboard our employees to the strategy. And according to our founder also and in line with the group's values, we focus on social commitment. And let's don't forget, part of the dividend that we pay out goes into social contribution and this is part of the ElringKlinger DNA because this is the way we are set up and also, we are in the process when we look at ESG for governance within the certification cycle in the five compliance management systems that we have.

So also, here there's a lot going on within sustainability and as well in the other areas that you see here. Again, performance process excellence, KPI based, management in the group, digital transformation to digitize the core processes of the company and also to work on the corporate culture and to improve that the big plan that we have that we really can put that into operation because without our employees, of course, a lot is said, but eventually not much gets done. So, we need to bring the employees here on board and this year we'll do a lot to do that.

Yes, when we come to the group financials, revenues €1.847 billion is a slight growth 2.7% relative to 2022. And if you look here in the middle, where's growth coming from? You saw it aftermarket for one and also e mobility. When we look at the rest relatively flat we have to say, we'll see that also in regard to the outlook. As I mentioned, customer diversification, product diversification, this is the formula for ElringKlinger. The largest customer you see here is 8% share.

So, we are not dependent on one customer which puts us into a good situation overall. EBITDA is €200 million is a plus 15.1% relative last year. I'm satisfied with that. Can it be higher? Would it be better to have it higher? Of course, but €200 million in my opinion is a comfortable situation here that we have achieved in 2023. EBIT adjusted, we said we would achieve 5% EBIT adjusted margin. We are at 5.4% with a €100 million from an amount. And if you look at earnings per share, we have €0.62 here for 2023. We have proposed €0.15 per share as a dividend payment. So overall, I think solid in this regard.

From an R&D part, we see that we are investing more in R&D, but we have to be careful, of course, in the situation where we are in right now that we are not stretching this. And there is a little bit a cap in this area I would say, but we are well within with 5.2% of sales, 5% to 6% we said. We are well within the boundaries that we have set. Net working capital 25.2% similar to last year. Target is to come below 25%. It's okay for now. Going forward, I think we have to work here and try to get below this figure. And in terms of CapEx here at 3.9% of sales €71 million we are still very hesitant in terms of CapEx spending which is of course having here in the situation that you have seen before with the investments, significant investments that go on in the new technologies is a sustainable for now is a sustainable situation.

When we look as a result of all this policy operating free cash flow for the year €37 million relative to €15 million in the past year is more than 100% increase. Net debt could be reduced by 11.3% to €323 million with a net debt to EBITDA a new low value for ElringKlinger Group of 1.6% and equity as well within our target here with 45.3% and €907 million on a good situation. So, when we look here in the aftermarket segment and sales has been increasing very much.

OE, we said, is more like a little bit horizontal. OE equipment and aftermarket generally a fine situation. So, when we look forward and we see in our main market's flat development. If we look at the bottom middle 90 million vehicles globally is at best is a flat development. If we look at the regions, North America looks flat. Europe looks a little bit on the weaker side and Greater China has maybe a little bit of growth. But overall from growth in existing business for maybe this year, next year we'll see not too much to be expected. And therefore, the growth story that I explained earlier is important.

I think that, that goes on and that we can further achieve some goals. We have ramp ups for e-mobility applications in 2024. There will be contribution coming out of that, but there is still with the new startups for electric vehicles, a lot of delays involved and therefore there will be growth, difficult to say as per day how much. What is the target now for 2024? We expect slight growth.

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For more, we do not see as of yet. Adjusted EBIT margin, we want to continue with a 5% of revenue operating free cash flow same level, 2% of revenue ROCE 6%. Net debt to EBITDA for a longer term we want to stay under 2.0%. And in terms of CapEx, I have taken that down 1% I see now as well for 2024. But mid-term, we try to achieve 4% to 6% of revenue as a guidance.

So, we look at the mid-term and we know we'll grow based on the orders on hand. We know that based on the activities that you have seen before, there's going to be optimization in the group going on. There will be a revenue cycle with contribution margin coming on. Therefore, we say EBIT margin midterm 7%. Operating free cash flow, we want to improve. From a ROCE perspective, we need to make the balance sheet smaller. We need to increase EBIT adjusted. And as a consequence, we'll have a better ROCE going forward.

Now if we look at the pre-tax working the weighted average cost of capital, we are not there where we should be. And our target is to surpass that amount that you see here in our annual document. Net debt to EBITDA, again, 2.0.

Here's our financial calendar and I'm coming to the end of my presentation. And I thank you very much for listening now. If you have some questions, I'd be very happy to answer those. Thank you very much.

Question-and-Answer Session

Operator

[indiscernible]. I have two questions. First one is on the adjustments you booked in Q4. Maybe you can explain a bit what's the reason for that especially in the other segment? And the second one is your margin target of around 5% implies a drop down in margin compared with 2023. What are the key reasons for, let's say, weaker margin development and what could be a chance for higher margin?

Thomas Jessulat

In terms of adjustments, we have been doing structuring and restructuring in the group. So, there is service business that's been part of the other segment that we have closed down. It is around testing for ICE engines and this is a significant part of Q4 development here on the margin target. I'm careful because we have some from some areas labor costs inflationary pressures that we will see in 2024. And on the other side, we have a flat core market that is, of course, something that depends on the growth continuation on the aftermarket and also on the ramp up of e-mobility.

Now there I'm I want to be more careful in the short term and this is essentially why I say we want to stick with the 5%. And there's upside as you may think. There's also some downside here and this is sort of the middle.

Frank Biller

Hello, I'm Frank Biller, LBBW. A couple of questions. First question is on the profitability in the fourth quarter. Very strong in the Engineered Plastics segment as well as in after-sales. Was here any special thing here happening in Q4 that the margin was nearly 25%, for example, here in the after-sale business? Second question is on profitability of EKPO. So, when I read these figures, it implies that the fourth quarter must have been profitable in my view because there are less negatives on the minorities here in the P&L. So that's the second question, what was here EKPU in the fourth quarter driving this profitability? And the other, the last question is on CapEx ratio. So, you are targeting around 4% to 6%. Is it significantly increasing in '24, let's say to a level of more than €100 million?

Thomas Jessulat

Yes. Thank you for your question. Let me start with your question number one, profitability. Engineered Plastic aftermarket in the fourth quarter, it was, for aftermarket particular strong fourth quarter. When we look at that Engineered Plastics to some extent too, but not is also worth to mention that we have in the OE business, our OE customers we have closed on a lot of compensation topics, the OE segment. And this is part of you may not see that so directly there in that segment.

But overall that has a positive impact in particular in Q4 on the group. On EKPO profitability, as I mentioned, in November we have received IPCEI funding up to €177 million over a couple of years. And here based on that nomination, we were able to capitalize some engineering expenses. And there in fact, what you say is a very positive quarter here in regard to that based on the nomination here for HFC funding. On the CapEx ratio 2024, no I don't think so.

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Any other question?

Okay. So, there's no further questions. So, I thank you all for your attendance. And we are really pleased to see you all here in person to be with us. And I wish you all Happy Easter holidays, Good holidays for you and your families and hope to talk to you and discuss with you again on one of the next events where we meet. And there is two dates that I want to give you. There is Q1 results on May 7th or the Annual General Meeting here on May 16th this year.

Thank you again all for your participation and you have a good day. Thank you much.

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