

# **Hexagon Composites ASA (HXGCF) Q4 2023 Earnings Call Transcript**

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**Body**

Hexagon Composites ASA (HXGCF)

Q4 2023 Results Conference Call

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Company Participants

Karen Romer - SVP of Communications

Jon Erik Engeset - CEO

David Bandele - CFO

Presentation

Karen Romer

Good morning, and welcome to Hexagon Composites' Fourth Quarter 2023 and Full Year Presentation. My name is Karen Romer. I'm the SVP of Communications for Hexagon. And joining me here in the studio in Oslo or the auditorium in Oslo is Jon Erik Engeset, who is the CEO of Hexagon; and David Bandele, who will be -- who's the CFO and will be presenting the results. We're going to start out today with the market -- the highlights from the quarter as well as a market update from Jon Erik followed by financials and the outlook.

After we've gone through the presentation, there'll be an opportunity to ask questions. If you're in our digital audience, you can just use the field to the right of the screen to send your question and we'll make sure it's asked up here and then also, of course, in the room here today. So it's lovely to see all of you. And without further ado, I will now hand over to Jon Erik.

Jon Erik Engeset

Thank you, Karen. Good morning. Happy to take you through Q4 and summarize 2023, which was a good year in our opinion, especially the top line development was very satisfactory. We passed the NOK 5 billion mark in the year and also markedly improvement in our EBITDA margins, although still plenty of room for further improvement fortunately.

Especially the Mobile Pipeline business unit in Hexagon Agility performed very well.

Record year and still growing. So very satisfied with that. Hexagon Ragasco had a somewhat soft second half. However, we had a record sign-up of new accounts, 20 new -- 21 new customers added to the portfolio, and a 5-year agreement entered into with our Saudi customer, Gasco. And last but not least, Hexagon Digital Wave, 54% growth year-over-year and a very important new long-term UE agreement signed now in January.

Arguably our most important slide, in 2023, our solutions enabled the avoidance of 1.5 million metric tons of CO2 equivalents. That compares to roughly 300,000 petroleum cars off the road for 1 year. We will revert with our own footprint. So we need to fulfill the audit of that, but it's in the ballpark, 300,000 tons equivalents, so a significant net impact. And just as another measure of comparison, the Norwegian combined CO2 emissions in 2022 were at 48.9 million tons.

So this saving corresponds to roughly 3% of the Norwegian emissions as a comparison. So we are not saving the world on our own, but we are making a very significant contribution. Looking at our financials. The revenues in the quarter 4 was NOK 1.437 million -- NOK 1.437 billion, up from NOK 1.27 billion in 2022. And the EBITDA amounted to NOK 126 million, and that was after restructuring and strategic cost charge of roughly NOK 7 million in the quarter.

So the EBITDA margin, up from 8% in '22 to 9% in '23. And then if you correct for that one-off cost is closer to 10%. Still a ways to go to our target of 15%, but we are on the right track. Looking at the different businesses, Hexagon Agility is now by far the largest, amounting to 83% of our total revenue and the strong growth in '23 of 24%. And already mentioned Digital Wave, a growth of 54%, still a small part of the business closely tied to the Mobile Pipeline business, but now amounting to 4% of the group revenue.

Hexagon Ragasco, roughly 13% of the revenue. But looking at the EBITDA, they have stronger importance for us than the top line indicates. Looking forward, short term and longer term, we are very keen to see the launch of the 15-liter Cummins engine. So some OEMs have now opened order books now in February, and we expect deliveries related to this new engine from Q3 of 2024. And then we expect strong growth from -- starting in the fall this year and then making up speed in 2025 and onwards.

The Mobile Pipeline business still growing, very strong backlog, record revenues last year, backlog at the beginning of 2024 at $150 million. And now we see growth for our products, not only in North America but across the markets that we operate in. In order to meet this growth, we are going to replace our winder in Lincoln. So that is an upgrade that will take place towards the end of Q2 according to plan. And this strong growth in the Mobile Pipeline business has a direct effect for Digital Wave.

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So the illustration to the right shows how we electronically recertify our TITAN modules. So in the U.S., there is a requirement to recertify every fifth year. And the first generation of significance of Mobile Pipelines was delivered in 2014. And that then we had a fairly good year also in 2019. So now in 2024, we need to recertify the modules that we delivered back in 2014 plus the ones delivered in 2019.

So this was the idea when we acquired Digital Wave after having over some years developed this technology, and this is now the market standard. The alternative to MAE is to do hydrostatic testing, which requires a disassembling of the modules with certain risks and less accuracy in the retesting. So it's safer, smarter and cost-efficient solution. Also on the Ragasco side of the business, we are working with Smart Solutions. The Linktra technology was launched as a pilot successfully in 2023.

And we've now taken the first serial order for this technology here in Scandinavia, 20,000 units will be delivered this year, and we see a growing interest amongst other LPG distributors, and we hope to secure further pilot orders and roll this out in a broader way going forward. Then looking at our Hexagon Purus business, where we hold 38%. They had another strong growth year and on track to reach their '25 target of NOK 4 billion to NOK 5 billion in revenues.

More importantly, maybe in the current sentiment, they are also on track to deliver positive EBITDA in 2025 as a combination of scale and an increased focus on costs. And I think it's very important to emphasize once again that more than half, 58% of the Purus business is hydrogen infrastructure.

So if you like, Mobile Pipelines for hydrogen. Exactly the same thing is happening for hydrogen in Europe, which has happened for RNG Biomethane in the U.S. that the fleets, they replace steel tube trailers with lighter, more efficient Type 4 composite trailers. And that is what is driving this growth, and that business is already EBITDA positive. On that note, I'll hand over to you, David.

David Bandele

Thank you, Jon Erik. So welcome, everybody, also in the audience joining us digitally. For the financials, then starting with quarter 4 2023. So Hexagon Group posted NOK 1.4 billion in revenues for a 13% growth, very much driven by Agility and Digital Wave businesses. When it comes to EBITDA, a healthy and solid increase of NOK 21 million to NOK 126 million for the quarter.

And the restructuring and strategic costs, actually NOK 11 million. So if we had included those, we can see getting close to double-digit EBITDA margins. But let's look at the full year. Q4 really capped off a very good year. NOK 5.2 billion in revenues, up 21% from the same period last year.

And as Jon Erik alluded to, Mobile Pipeline very much driving that growth, but also significant growth in Digital Wave as well. And then you can see significant recovery in EBITDA levels, up NOK 132 million to NOK 480 million for the year. So -- and we did take some -- also some strategic costs in Q3. So we would have been over the NOK 500 million mark if we normalized. Let's dig into Agility for Q4.

They posted NOK 1.2 billion for 21% growth. Apart from the continued strong performance in Mobile Pipeline, there was also quite a solid performance in transit bus for Q4. We note that heavy truck for this quarter isolated was higher year-over-year and also a touch higher quarter-over-quarter as well. Going over to EBITDA. You can see over doubling EBITDA growth there.

So NOK 110 million in EBITDA for Agility. And the major drivers continue to be then the cost-adjusted pricing, which is effective and the high Mobile Pipeline volumes as well. We did have some headwinds, mix and a mixed bag of, you can say, Q4 and audit adjustments and those types of things. Plus, we had some -- we've got initiatives we want to push through, that will be very margin accretive for the future. So we actually took our production rates down in Q4 on cylinder production just to ensure these initiatives were put into place.

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So full year, Agility grew 24% top line to NOK 4.3 billion. And you can see that on the EBITDA side as well, the growth to NOK 381 million is significant. Very much the same reasons. I will just make sure -- I would just point out that on the top line for the full year, we still have a year of relatively low truck volume. So more to come there as we go into '24 and 2025.

The pace of recovery of the margin, we are pleased to go from 6% to 9%, as you heard Jon Erik, more to come. And of course, a lot of that margin recovery also is dependent on the volumes and particularly in truck. So as we increase our truck volumes, we will definitely benefit from the scale. Hexagon Ragasco, firstly, some words about Q4 2022. So that was, by far, a record quarter last year, where we did NOK 234 million in revenues.

There was unusually high stocking, you remember the period at the time within our European customers, apologies. This year, we did more of a typical revenue for quarter 4, NOK 171 million, solid enough. These lower European volumes though offset partially at least by a new large order actually in the region of Oceania. On EBITDA then, given the difference in volumes year-over-year, you can see a reduction in EBITDA year-over-year, but the NOK 26 million for a solid 15% EBITDA margin still solid enough in these conditions. And the full year for Hexagon Ragasco, slightly under last year at NOK 679 million in revenues.

So weren't able to offset all the destocking effects in Europe with deliveries to the rest of the world. But I do note it's been a fantastic year of geographic expansion. Middle East has been very strong. And of the 21 new customers that Ragasco brought on board this year, that represents 16% of the annual volume. So a great activity there.

And then the margins, you can see, EBITDA was NOK 114 million, and we did hold our EBITDA margin year-over-year at 17%, still the highest EBITDA margin in the group. Going on to Digital Wave. Fun fact, if you see the revenue there, NOK 58 million for the quarter, just 2 years ago, that was the revenue for the full year in Digital Wave. So the growth has been impressive. Last quarter was also strong, but we grew 26%.

And then when it comes to EBITDA, we posted NOK 10 million in EBITDA against the NOK 7 million same period last year for a EBITDA margin of 17%. So the MAE business that Jon Erik covered grew twice -- 2x over the quarter. And also UE business had some growth. I will say, results are slightly skewed due to delayed shipments in the UE business. So we had built a lot of our equipment and managed to actually get all the shipments out before the end of the year.

So hence, the enhanced margin you can say for Q4. When we look at the full year, Digital Wave then grew a top line of 54% for NOK 179 million. And on the EBITDA side, you can see closing at NOK 8 million, up NOK 1 million from the same period last year. So Q4 was crucial in really making the year as profitable as it can be. Now we are still ramping up growth costs in Digital Wave.

So if we actually had a steady state, if we didn't invest for future revenue, we would have gained already another 10 percentage points. Much more scale to come in Digital Wave, so even more margin accretion in the future. So pleased to say that on the group leverage, we ended up with a net interest-bearing debt of NOK 954 million. This led to a leverage position actually just below 2x, and we had available liquidity of NOK 733 million coming out of 2023. A quick update on Hexagon Purus.

Our investment, we did contribute NOK 0.2 billion in the form of a convertible bond that was settled already early February. This helps support Hexagon Purus's EBITDA breakeven goal in 2025. I'm really, really, really pleased to see that they attracted a Hy24 as well as Mitsui as anchor investors for them. Now we had an accounting-driven noncash impairment of NOK 0.7 billion for the quarter. But of course, just to point out that together with the gain realized in deconsolidation in Q2, the net effect even with the impairment is still plus NOK 1.65 billion positive to the bottom line.

So it's customary before we close out the year to give ourselves a scorecard. And this year is no different. We still see very strong demand for our sustainable solutions, and we provide solid fundamentals for our business performances. So what's there not to like? 21% top line growth.

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We passed NOK 5 billion mark. We recorded NOK 480 million in EBITDA, as I mentioned, more to go. And on the environmental side, we avoided 1.5 million metric tons of CO2 equivalents. Combined with very good working capital management, we were able to generate free cash flow of NOK 465 million for the year. This is on a solid balance sheet with 50% equity ratio and our financial investment in Purus.

Bearing in mind, Hexagon Purus has Hexagon heritage products, route to market, technology and a fantastic future. And our financial holding is 38.4% there. I'll just pause a little bit for the outlook and just let 2023 pass. Okay. On the outlook side, it's still too early to say, to be fair.

But this X15N launch, we are looking forward to. It's going to make a game of 2 halves. We

will see relatively low truck volumes for the first half of the year and significantly increased volumes once the engine is launched from the beginning of Q3. So consequently, our -- both our revenues and our profitability, of course, will be rather back-end loaded. But on the revenue and profitability side, we still see ourselves very much on track for our 2025 targets.

2025 targets being over NOK 6 billion in revenues and around about 15% EBITDA margin.

Diving into what we can say and see, if we start with Mobile Pipelines and the cylinder manufacture and sales to Mobile Pipeline for hydrogen in Purus, that is very strong, as Jon Erik covered more or less a full backlog for the year. So that is something we can depend on. And again, the Purus business seems to be going from strength to strength, the infrastructure business. So we expect strong sales to Purus as well.

On the transit and refuse truck, transit remains a lumpy business, but still healthy in Europe and the U.S., whereas a refuse truck we expect to be steady. I'll come back to truck in a second. LPG cylinders, so the Ragasco business, we feel will be another stable year in 2024. And whereas Europe is a little bit soft, we have a major customer that's rationalizing CapEx.

But of course, as we've seen, we're quite successful in rest of the world and developing markets there.

We also believe quite highly in the Middle Eastern market for '24. So a stable year there. Digital Wave, more or less more of the same, profitable growth. So back to truck. So truck is about, you can say, 1/3 of our Hexagon Agility's revenues.

So it's obviously a key area. We still see continued excess capacity in the freight sector in North America. And that's sort of been the reason why there have been reasonably muted volumes during the year. As we come out of Q4, typically with this sector, it has a high Q4 and then a lower Q1 as it digests its stock and then continues on from there. So we'll have a typically low Q1, but we expect a weak Q2.

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So this is where we expect that people will wait for the launch of the new engine, and we should see those orders. We've already actually received some introductory audits. These are very few advanced orders, which is pleasing, but most of the order book will then start happening in earnest March, April time. So we expect a little dip, like say, weakness in Q2 and then a significant pickup for the back end of the year. But before we launch into Q&A.

So key takeaways from today, 21% top line. We had record performances in Mobile Pipeline and Digital Wave. RNG drivers remain strong. This new engine launch, the X15N is a key inflection point for our volumes, and that seems to be on track as our targets for 2025. Thank you.

Question-and-Answer Session

A - Karen Romer

Okay. We are now ready for Q&A. For those of you in the digital audience, again, it's the field to the right of your screen, feel free to submit your questions there. But do we want to start here in the room? Are there any -- yes. We need a microphone. Right here. Thank you.

Hans-Erik Jacobsen

Hans-Erik Jacobsen, Nordea. On the cost, [ so pricing in ] Agility, has that come to end or could we expect further margin improvement from -- renegotiated on new contracts within that area?

David Bandele

I think there's still some more full year effect in 2024 versus '23, of course. But I think the volumes, we're not seeing -- the effects are quite strong. They are adjusting the costs well, but you're not seeing the full effect because of the lower volumes, particularly in truck.

Hans-Erik Jacobsen

And on the new Cummins engine, it's just a couple of months before it's launched and ready for clients. Haven't you seen any orders coming in yet, although the engine is quite close to come into production?

David Bandele

Yes. It's one company with 2 brands of truck involved in very introductory audits. So these are a handful, you can say. And we have seen our share of that.

Jon Erik Engeset

To that question though, so, so far, it's only prelaunch orders. So it's really only now in these days that the OEMs start opening their order books. So we will only start to see the true orders come in over the next few months, and then the launch itself will be in the second half.

Karen Romer

Do we have any other questions here in the room? Okay. I can take one from the audience -- from the digital audience in the meantime. So for Jon Erik, what is the reason for the lower activity in Ragasco, lower revenue in Ragasco and slower outlook for the business?

Jon Erik Engeset

Yes. So to take the last part first. I'm not sure if the outlook is so bad. We see a lot of new customers coming in and very interesting leads outside Europe. But we have seen softness in Europe.

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And in hindsight, it seems that there was a bit of overstocking in '22 and '23. So during COVID, especially the demand was very strong. And it seems that the distributors nearing the end of 2023 chose to reduce their inventories. So this is a temporary challenge. So we don't see a fundamental change in the market, but it did have some impact in the second half of '23, and we expect it to continue to have impact in the first half of '24.

And then as mentioned, we are much more optimistic about the opportunities outside Europe.

Karen Romer

Excellent. And for you, David, about Hexagon Purus, if the share price falls further, does this mean another impairment?

David Bandele

No, not automatically at least. So the impairment is obviously accounting driven. We have to balance accounting prudence with our view of the future of Purus, which we feel is bright. So there's no automatic change if the share price goes further down.

Karen Romer

Okay. Just keep an eye over here, but I have some more from the digital audience. I think perhaps for you, Jon Erik, you indicated strong growth in natural gas heavy-duty trucking with the new Cummins engine in the states. How is that growth compared with hydrogen? And how about in Europe?

Jon Erik Engeset

So the U.S. and the European markets at this stage are very different when it comes to clean energy alternatives. The U.S. is very much RNG focused for now, if you talk about transportation. While in Europe, we still have a debate ongoing.

And we are in active dialogue with the European Commission and Parliament to try to get factual arguments across in their policy making. So -- but I think in our view, the politicians on the European side are a bit more dogmatic and focused on 0 tail pipe emissions. While in the U.S., there is a more pragmatic approach and looking at the total impact on the CO2 emissions and for that sake, the NOx emissions. And the result of that is that the contrary to what many believe, the CO2 reductions in North America by far outpace the reductions in Europe. In Europe, actually, the number of diesel trucks went up from 2021 to 2022.

We're still waiting for the numbers in '23. That said, the hydrogen business is also very promising. The mobility part of the heavy-duty truck is a bit behind schedule, but things are starting to happen as we speak. So Nikola has launched their hydrogen truck and there are other brands also following suit. Then it's important to emphasize that Purus's business for now is very much based on the distribution segment.

So the containers for hauling of hydrogen. And that business is booming in Europe. It's not the same structure in the U.S. In the U.S., there is more transportation of liquid hydrogen. So for now, at least, that is primarily a European growth opportunity.

And then Purus is also about battery electric, where we see very strong growth driven by the CARB regulations in, first and foremost, California, but also another 12 states in the U.S., where they require a certain percentage of the fleet to be 0 emission. So great growth prospects for all in absolute terms, the RNG growth in North America outpace the mobility growth in Europe and for hydrogen. That may change in the future. But as I think we've said many times in this room, for the foreseeable future, RNG needs to be a very significant part of the solution.

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Unfortunately, there is still a case to be made towards the European policymakers on that point.

Karen Romer

Very good. And continuing, I think, back to the Cummins engine. Congrats on a strong finish in 2023. Can you be a bit more specific on how many trucks in the U.S. will use the new Cummins engines in '24, '25 and '26?

Jon Erik Engeset

It's very hard to be specific at this point in time. We are anxious to see the order book when it now opens. But the addressable market increases by a factor of [ 3 ], and it's also a much more efficient engine than the current 12-liter. Not only does it apply to a wider range of trucks, but it's more efficient, 6% to 7% more energy efficient. So those who have chosen not to use the 12-liter even if they could, may now choose to use the 15-liter because of the energy efficiency improvement.

This engine has been running in China for 3 years, and it's now -- it's a real hit in China. So unlike new engines that normally when they get launched, they have baby sicknesses. This one is tested, and there is reason to believe that the introduction to the U.S. market will be quite seamless. So we have major great expectations for this launch.

But we are as excited to see the order book developing when we get a bit further into 2024.

Karen Romer

Excellent. David, how big would the effect of a delay in the certification of 15-liter have on the '24 results?

David Bandele

On '24 results, yes, it can be noticeable, absolutely. So we're talking about the back end of the year development. And there is fairly a lot of volume put on trucks and revenue potential obviously. And so it can have a noticeable effect for sure. But delay, it doesn't mean sales are going away.

So what it doesn't -- what it may do for '24, it will just boost '25 and beyond. So I think on that scenario, we're comfortable, and it's more about producing and having all the capacity ready to deal with this demand. We have the #1 market position and the amount of cylinders, et cetera, is a key strategic advantage that we have. So in order to react quick to the market, we certainly have and will have our capacity in place.

Karen Romer

Excellent.

David Bandele

Whatever happens.

Karen Romer

Okay. So I have one more question here from the digital audience. Anything in the room? No. So again, for you, David, I believe the 2024 consensus revenue is NOK 5.4 billion and EBITDA is NOK 648 million. Do you view this as a reasonable -- as reasonable expectations for 2024?

David Bandele

It's a reasonable expectation, absolutely. But it's dependent on the last question then is on the 15-liter engine development for 2024.

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Karen Romer

Excellent. Well, that's all I have from our digital audience. I'd like to thank everybody for joining us today, and we look forward to seeing you at our Q1 presentation. So thank you.

Jon Erik Engeset

Thank you.

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