

# **Hexagon Purus ASA (HPURF) Q2 2024 Earnings Call Transcript**

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**Body**

Hexagon Purus ASA (HPURF)

Q2 2024 Results Conference Call

July 18, 2024 02:30 AM ET

Company Participants

Mathias Meidell - Investor Relations Director

Morten Holum - Group Chief Executive Officer

Salman Alam - Group Chief Finance Officer

Presentation

Mathias Meidell

Hi, and welcome to Hexagon Purus Q2 2024 Presentation. We apologise for the slight delay, but we had some technical difficulties at our end, but now we are ready. So, my name is Mathias Meidell, and I am the IR director of Hexagon Purus. I will be moderating from the studio in Oslo.

And from the studio I'm also joined by Group CEO, Morten Holum, and Group CFO, Salman Alam. The agenda for today includes, as usual, the highlights from the quarter, a company update and the financials and the outlook. We will end the presentation with a Q&A session, so please feel free to enter your questions via the function on your screen.

So, with that, I will pass the word over to you, Morten, who will take us through the highlights of the quarter.

Morten Holum

Thank you, Mathias, and good morning, everyone. Thanks for joining our webcast this morning. And for you Scandinavians out there, I realize that we are right in the middle of the summer vacation period, so I appreciate you taking the time to follow our webcast this morning. In many ways, this is a business-as-usual type of quarter where we continue our track record of strong growth and we'll continue to improve profitability according to the plan. But in other ways, this is also a special quarter in that we have now reached positive EBITDA for our hydrogen business in Europe and North America.

This is an important milestone for us and ahead of plan. So let's look at the highlights for the second quarter. The key highlights are, number one, we continue to deliver strong revenue growth both on a quarterly and on an LTM basis. Number two, we have reached EBITDA breakeven for our hydrogen business in Europe and North America. The HMI segment is now EBITDA-positive year-to-date.

We're very happy to have reached this important milestone, which confirms that we are well on track to reach our targets. Number three, we successfully launched the Tern truck that we will deliver to the Hino program. This will be an important growth driver for the quarters ahead as that business finally will get into revenue position. And finally, number four, our partnership with Toyota was also made public in Q2, where we will supply our hydrogen systems and our battery systems for their fuel cell electric powertrain kit for heavy duty trucks in North America. This adds to an already strong portfolio OEM customers for our battery and hydrogen electric trucking portfolio.

But first revenue, we had strong year-over-year revenue growth. Q2 revenue of NOK528 million is 60% higher than Q2 last year, an all-time high revenue during a single quarter for Hexagon Purus. Looking at last 12 months revenue in the middle chart, we are now at NOK1.682 billion, 44% higher than last year. This brings comfort to our path towards our full-year target. Standing at an LTM revenue of almost NOK1.7 billion halfway into the year, we're confident that we're well on track to reach our 50% revenue growth target for the year.

Looking at EBITDA, we see that profitability keeps steadily improving quarter-over-quarter, in line with higher volume and scale. We ended with a group EBITDA margin of minus 18% in Q2. And remember now, this is before we start generating revenue in the Battery and Vehicle Integration segment. We expect to start recognizing some revenue there now in Q3, as the initial preproduction trucks will be delivered to Hino and Daimler. And the HMI segment, our hydrogen business in Europe and North America is EBITDA positive both for the quarter and year-to-date.

So things are definitely moving in the right direction for us. I'm satisfied that we now start seeing higher volume coming out of the new manufacturing footprint. Despite being at an early stage of the overall ramp-up curve, we have been capacity constrained for some time. So I'm happy that we now start seeing the positive impact of higher capacity. But maybe the most comforting aspect of our Q2 performance is the EBITDA development and the fact that we reached EBITDA breakeven in our HMI segment.

And looking ahead, further volume growth at solid gross margins will quickly give us the benefit of higher scale effects and fixed cost absorption. And since we will start generating revenue in the BVI segment now in Q3, we expect profitability to continue improving towards year end. Looking at the revenue composition, we see that hydrogen infrastructure continue to be the most important driver for revenue growth, up 82% from last year.

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Besides hydrogen distribution modules, which is the largest product area within hydrogen infrastructure, the growth in the quarter is also supported by strong underlying growth for mobile refueling and stationary storage, albeit from lower levels. It's also great to see that hydrogen mobility now starts to contribute meaningfully as a growth driver, just as we have expected.

The growth in Q2 was driven by transit bus and heavy duty truck. Hydrogen mobility will continue to play an important role in driving revenue growth in the second half, driven by increased deliveries to transit bus customers Solaris, Caetano and New Flyer and Nikola on the heavy duty truck side of course. As I mentioned earlier, revenue in the Battery and Vehicle Integration segment was not meaningful in this quarter, but this is now right around the corner. I'll come back to that shortly. And the revenue decline in other applications was mainly due to lower activity in industrial gas and aerospace.

We see these mainly as timing effects and not representative of the underlying activity. Both of these areas are growing fundamentally, but they are also smaller segments and still quite lumpy from quarter to quarter. So not a lot of revenue in BVI this quarter, but this segment will play a major role as a growth driver in the coming quarters. As I said, we start delivering the first vehicles to Hino and Daimler now in Q3. And these are preproduction test and validation vehicles and demo trucks that we build in our Ontario, California facility.

But we can still invoice those. And we will then move the vehicle integration and assembly activities to Dallas once the facility is ready towards the end of Q3, which will then significantly increase our capacity and our ability to grow revenue. So big things to come. The order backlog at the half-year mark stood at NOK1 billion, almost 90% of that is for execution in 2024. So that gives solid comfort for our revenue target for the year.

The backlog continues to be dominated by hydrogen business. Most of it is hydrogen infrastructure due to long order lead times, but hydrogen mobility has increased its relative share of the backlog. And you can also see that battery electric mobility is almost nonexistent in the backlog. So here the order lead times are much shorter, but we use a strict definition, as you know, of order backlog. They have to be firm orders.

And we have not yet received firm purchase orders for the trucks that we plan to deliver now in Q3 and in Q4. But keep in mind that these agreements that we've signed with Hino and Daimler has an estimated combined value of more than $2 billion from now and towards the end of the decade. So the volume is fairly large in our context. For hydrogen infrastructure, we've sold the majority of the distribution module capacity for '24 and for '25 most of the volume is expected to come from existing long-term agreements. And the customer discussions on build slots for '25 is starting now in Q3.

And for hydrogen mobility, the dialogues with our transit and truck customers suggest that we can expect further call offs in '25 under the existing LTAs. And for battery electric mobility, we expect to receive orders for the first test and validation vehicles and the demo trucks within weeks and further POs for the Q4 volumes to be placed around the end of Q3. So in total, we're comfortable with the order situation. The order stock is a bit lower than last quarter and last year, but we have good line of sight to the expected business for 2'4. And as for next year, many of the customer discussions for 25 within the, yes, within the longer lead time infrastructure business is happening now in Q3.

So we will be a lot wiser a bit further into the second half of the year. We get a lot of questions around backlog and it's important to understand the order dynamics in our business to avoid drawing the wrong conclusions. Many equipment providers in the emerging hydrogen space are characterized by fairly long lead times, mostly due to the heavy engineering work involved and the high level of customization. But our business is different. We have more the characteristics of a mobility business.

And here the order dynamic is quite different. In the mobility context, you spend a significant amount of time upfront to develop a solution together with the customer. And then once that's done, you deliver a standardized product and you work off of a negotiated long-term agreement with frequent call-offs made relatively short time ahead of delivery. The key thing that makes this possible is standardization. Once the product has already been developed, there is no engineering or customization involved ahead of each customer delivery.

If you look at our industrial gas business, it's developing actually much in the same way. So in that business, we are an OEM of distribution modules, and these modules are, yes, 90% standardized, and then you customize the interface of that module according to each customer specification. And over the past few years, we have engineered a standard for each of our large customers. So these modules now can be ordered off the shelf and delivered with much shorter lead time because there is no engineering work involved. This is a great benefit for us and a great benefit for our customers, but it also lowers the order book visibility.

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So then looking at the different dynamics within the Company for hydrogen distribution systems, we typically see purchase orders six to nine months ahead of delivery. Two years ago, most of our customers were at the higher end and even higher than that on -- of that range. And now with standardized solutions for our large customers it's driving this towards the lower end of the range. For bus and truck, the lead time is a lot shorter, three to four months for bus and 6 to 10 weeks for truck. Most of these are serial deliveries of already developed products, so call-offs from multi-year agreements or frame agreements.

So we have less order visibility on that, but what we do have is close and frequent dialogues with our mobility customers to compensate for lower order visibility. These dialogues give us insight into what their forecast look like so we can get a good sense of what and when they plan to order. As we now grow our business, the relative order backlog visibility is going to decrease simply because of the nature of the business we're in. The backlog metric becomes a bit less valuable or less predictive, if you will, of future revenue. It's still a valuable metric, but it will mean something different in the future than what it has meant in the past.

We expect continued strong demand for '24 and '25, despite this not yet being visible in the current order backlog. But based on current customer dialogues and our portfolio of LTAs, I'm confident with the outlook for the business. The largest business, by the way, that's not yet in the order book and the largest driver of growth for us in 2025 is the BVI business. And they're the deliveries of battery electric and heavy duty trucks to Hino and Daimler programs. Yes, we need to consider the active market we're in on top of that.

We see high commercial activity across most applications. And I expect that we will also be able to land new contracts on top of those in our existing portfolio. And by the way, like I've said many times before during our quarterly presentations, I still worry more about execution than I worry about demand. Looking at the BVI side, in May we successfully unveiled the Tern RC8 at the ACT Expo show in Las Vegas in partnership with Hino Trucks. The truck is based on Hino chassis and will be sold exclusively through Hino dealers, but its branded term.

We have a short video so you can get a better idea of what it looks like in real life. So, let's take a look.

[Audio/Video Presentation]

Morten Holum

This truck is tailored for the North American markets and aligns well with the Advanced Clean Truck and the Advanced Clean Fleets regulations in California. The key word is practical electrification. New regulatory requirements are mandating fleets to integrate zero emission vehicles into their operation, and OEMs will in the coming years have to sell an increasing number of zero emission trucks in order to continue selling diesel trucks. So, staying compliant with these new zero emission mandates is a significant challenge for the industry and for the fleets. Electrification doesn't make sense everywhere, at least not today, so the technology and infrastructure is not in place to enable mass adoption, and battery electric technology does not work particularly well when you need to carry heavy loads over long distances.

This is where hydrogen makes a lot more sense. However, there are use cases where battery electric trucks fit well with existing duty cycles and operating patterns, and where the TCO works already today. This would be use cases where routes are shorter, typically within city limits, where you need a powerful yet maneuverable vehicle, and where you're back to base to charge at night. The Tern RC8 truck is the industry's smallest Class 8 truck with the shortest wheelbase, which makes it perfect for things like metro regional food and beverage logistics. The combination of high power, short turning radius and optimal range makes it possible for fleets to integrate this truck into their operation as a direct replacement of a diesel-powered truck.

So this truck will hit the sweet spot of a market segment where electrification is practical already today. The Tern truck will be sold exclusively through the Hino dealer network. And the value of a solid dealer network should not be underestimated. It doesn't matter how good your vehicle is. In commercial trucking, you will not be successful without the strong network for sales, service and support.

And Hino has a world class dealer network, 240 dealers across the U.S. And the great thing is that all of them are already trained on high voltage systems since Hino has been already selling hybrid trucks in the U.S. for more than 10 years. So these are the dealers that will service the vehicles since Hino is responsible for aftermarket service and support under our distribution agreement with them. Our initial focus will be California, since this is the most forward-leaning state when it comes to zero emission, with the strongest regulatory requirements and the strongest and most supportive incentives.

So we've already had our first dealer event in California where we presented the Tern truck to the Hino dealers in the state, and the feedback was very positive. Everybody is looking forward to getting their hands on the first demo trucks, and we will start delivering the first ones later this year. Last week we secured funding in Canada of up to CAD8.5 million or around NOK67 million from the authorities in British Columbia, as part of their CVIC program, the Commercial Vehicle Innovation Challenge to support growth in British Columbia's zero emission industry. The grant is subject to certain milestone criteria being met, which by the way we are confident on meeting. But this is to support costs in our Kelowna facility to further develop our leading battery electric vehicle technology for the Tern truck, partly for this year and partly for next year.

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This is a welcome addition that helps lighten our cost burden in the ramp-up phase for the BVI business unit. So we're obviously super happy about this. Our partnership with Toyota Motor North America to supply our hydrogen storage system and battery systems for their fuel cell kit for heavy-duty trucks was made public in May, signaling the transition from the development phase to the commercial production phase. Our collaboration with Toyota goes back to 2017 when they started the first development of the fuel cell electric powertrain kits for Class 8 trucks. We were part of their proof of concept, their Alpha truck for the Port of Los Angeles when the port decided to start working on technology to reduce harmful emissions in and out of the port.

The partnership started with hydrogen storage cylinders, expanded into fuel systems and further into battery storage systems after they became aware of our class-leading heavy-duty battery system. So the fuel cell kit will be sold to heavy-duty OEMs for hydrogen-powered Class 8 trucks. Toyota will make the fuel cell, and we will supply the hydrogen fuel system and the battery system. And one of the OEMs that have signed up for this kit is Kenworth, as you can see in the picture. And Toyota expects that other OEMs will eventually sign up as well.

So they have been granted a zero emission powertrain executive order from CARB for their fuel cell kit. And this certification will help commercial truck OEMs and operators comply with increasing strict emissions regulations in the state of California. We're very happy with the Toyota relationship and to be part of Toyota's hydrogen program in North America. And for us, again, this adds to an already strong portfolio of OEM customers for battery and hydrogen electric trucking. In terms of our capacity expansion and investment program, we're almost at the finish line.

Dallas is the 7th and final site to become operational as part of this program. And we're now in the process of making the required tenant improvements and moving in equipment. This is mostly vehicle assembly equipment. So in relative terms, it's a much quicker and easier job compared to installing things like a cylinder manufacturing line or a battery module assembly line. We expect the facility to open later in Q3 and be ready to deliver volumes to Hino and Daimler in Q4.

With Dallas ready to open soon, our global manufacturing footprint is now more or less complete. There will be some minor follow-on investments in equipment to remove bottlenecks and increase productivity and so forth as we go along. But the heavy lifting in terms of CapEx will be behind us when we get to the end of this year. Additional larger capacity increases beyond this program is not on the table for now. Our focus for the coming year or two will be to optimize this current footprint and generate profits and cash.

However, when the time eventually comes to expand further, we have room within this footprint to grow. So the next wave of capacity increases will be a lot cheaper and faster to execute than the program we are finishing now. On reflection, we took on a significant challenge embarking on this expansion program. We have prepared seven new facilities on three continents, more or less simultaneously within an 18-month time frame. That's quite a challenge.

But it has been executed very well. We're not completely done yet, but I cannot emphasize enough how proud I am of the Hexagon Purus team, the team members in our different locations that have made this possible. I'm extremely impressed with the character of the Hexagon Purus organization. And besides being proud and impressed, it makes me confident that this organization has what it takes to succeed over time. One final thing before we turn to the financials.

I want to highlight the achievements of Norwegian Hydrogen. They have now finally started production of green hydrogen here in Norway. Their Hellesylt hydrogen hub is dedicated to enabling zero emission in the Geiranger World Heritage Fjord, using landlocked hydroelectric power to produce green hydrogen. And the plant has now produced its first green molecules and is expected to gradually ramp up its output, ultimately reaching a maximum capacity of 1.3 tonnes per day. The first deliveries from Hellesylt will be made to Veidekke, a leading Norwegian contractor that will use the green hydrogen to decarbonize asphalt production.

To Cyan Energy, who will use the hydrogen to generate enough power to enable high-capacity electric vehicle charging. To a maritime school vessel that we incidentally provided the onboard hydrogen fuel system for. And finally, to Norwegian Hydrogen's own subsidiary, Vireon, who will now start building the first high-capacity hydrogen refueling network for trucks in Norway, focusing initially on the main transport corridor between Trondheim and Oslo. This is a small but an important first step to enable the establishment of multiple zero emission solutions in Norway. Norwegian hydrogen is an enabler for the hydrogen economy and thus an enabler of our business.

And as you can see, they are using our distribution modules to move their hydrogen. And it's great to see that things are finally starting to move in the right direction. So those were the main points from the second quarter.

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And with that, I will hand the word over to our CFO, Salman Alam. Salman?

Salman Alam

Yes. Thank you, Morten, and good morning, everyone. Thanks for tuning in. Revenue-wise, as Morten mentioned, the second quarter of this year was yet another quarter where we delivered record-high revenue. Revenue in the quarter came in at NOK528 million, which is up about 60% year-over-year.

Similarly, year-to-date in 2024, we recorded revenue of NOK935 million, which is 63% higher than the same period last year. Both the growth in the quarter and so far in 2024 has mainly been driven by our hydrogen infrastructure and hydrogen mobility business. Total operating expenses ended at NOK625 million in the second quarter of 2024, up from NOK419 million in the same quarter last year. Our cost of materials ratio was 62% in the quarter compared to 54% in the same quarter last year and 59% year-to-date in 2024. This development is generally in line with expectations.

And quarterly fluctuations in materials cost margin is to be expected, driven by product mix and certain special items that fall into the -- into that category periodically. Payroll-related expenses were NOK195 million in the quarter, up from NOK156 million in the same quarter last year, but decreased significantly year-over-year in relative terms in comparison to revenue. Subtracting total operating expenses from total revenue, earnings before interest, taxes, depreciation, and amortization ended at minus NOK97 million in the second quarter of 2024, which is equal to an EBITDA margin of minus 18%. This is a significant improvement compared to the EBITDA margin we saw in the same quarter last year of minus 27%. Similarly, our year-to-date EBITDA margin is minus 21%, which is up from the minus 35% we saw in the same period last year.

This trend is consistent with our expectations of overall improved profitability in 2024 as you recognize more revenue at solid gross margins and you get the scale and operating leverage effect. Moving below the EBITDA line. Depreciation ended at NOK50 million in the quarter compared to NOK31 million in the same quarter last year. Generally, the increase in depreciation is caused by a higher balance of depreciable assets due to our capacity expansion program. Of the NOK50 million, we had in depreciation, about NOK34 million relates to depreciation of property, plant and equipment as well as amortization of intangibles, and about NOK16 million relates to right-of-use assets depreciation.

The resulting EBIT for the quarter was minus NOK147 million versus minus NOK120 million in the same quarter last year. Losses from investments in associates, which reflects our minority shareholdings in Cryoshelter and the systems joint venture company in China ended at minus NOK2 million in the quarter and was largely unchanged compared to the same quarter last year. Finance income in the second quarter was NOK11 million. About NOK6 million of this came from interest income on bank deposits and the remaining NOK5 million is due to foreign exchange fluctuations. Finance costs in the quarter was NOK86 million, of which NOK52 million is related to noncash interest on the two convertible bonds we have outstanding, and another NOK11 million is related to interest on lease liabilities and other interest-bearing debt.

The remainder of those -- of that amount relates to foreign exchange fluctuations primarily. At the group level, we are not yet in a taxable position and tax expense in the quarter was minus NOK2 million. So loss after tax ended at minus NOK221 million versus minus NOK147 million in the same quarter of last year. Moving on to the segments. And just as a reminder, we will start off with Hydrogen Mobility & Infrastructure segment.

This, we abbreviate as HMI. This segment is then the business unit that manufactures hydrogen cylinders, not hydrogen systems, for the storage of hydrogen onboard, either off-road or on-road vehicles or for infrastructure purposes such as distribution of hydrogen from the point of production to the point of consumption. It also includes our industrial gas business in Europe and the aerospace business that we have in the U.S. Looking at the financials for the segment, there are quite a few positive observations to be made. We are now increasingly starting to see that the capacity expansion program that we've put in place over the past couple of years are flowing through to the P&L, especially within the hydrogen infrastructure segment.

Revenue in the second quarter for the HMI segment was NOK526 million, which is 71% higher than the same period last year. The largest revenue component was Hydrogen Infrastructure Solutions, which made up 62% of the revenue in the quarter and showed 82% growth year-over-year. Hydrogen distribution modules makes up the majority of revenue in this application vertical. And in the quarter, we had product deliveries to blue chip customers like Air Liquide, Linde and Plug Power. The second largest application area in this segment was hydrogen mobility applications, which continued its strong growth momentum from the start of the year, made up 28% of revenue in the quarter and revenue increased by more than 4x compared to the same quarter last year.

The drivers of this increase were increased deliveries to our transit bus customers, such as Solaris and Caetano combined with increasing deliveries to Nikola. The other segment which consists of our industrial gas and aerospace business had lower activity compared to last year, mainly due to timing effects. Moving to the year-to-date chart. We see the same trend that we saw in Q2. Total revenue for the segment is up 69% year-to-date compared to the same period last year, and the growth drivers is again the hydrogen infrastructure and the hydrogen mobility segment.

Moving to the right-hand side of the page. As Morten already mentioned, we're very pleased to see that the hydrogen storage segment is now actually past the point of EBITDA breakeven and reported NOK17 million of positive EBITDA in the second quarter, which is equal to an EBITDA margin of 3%. This is in line with our stated ambitions of reaching EBITDA breakeven for hydrogen business during 2024 and adds further confidence to our EBITDA breakeven ambitions for the group as a whole during the course of 2025. The positive contribution in the second quarter also brings the year-to-date EBITDA for the segment into positive territory. Remember that in the second quarter of 2023, we had significant positive one-offs related to our Aerospace business, which explains the positive EBITDA in that quarter in isolation.

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Moving to our Battery Systems & Vehicle Integration segment, which we abbreviate as BVI, this is the business unit that does battery systems production and complete vehicle integration of battery electric and fuel cell electric vehicles for the North American market. We also have a complete suite of proprietary key components required for electrification of heavy-duty trucking and many of those components and that technology is IP protected. The financials for the BVI segment are influenced by the prototype and the ramp-up mode that this business unit is currently in and that it has been in for a while. The team has spent many years developing a leading battery electric technology offering for commercial vehicles for North America. And we have secured some major commercial agreements with blue chip customers like Toyota, Hino and Daimler.

This is a strong testament to the market position that we've built up in this space. And the first trucks to Hino and Daimler are expected to be shipped in the second half of this year. And so we're right before the point that we start recognizing commercial revenue, which is quite exciting for us. In the second quarter, we had NOK2 million of revenue, which brings the year-to-date revenue to NOK21 million. Year-over-year comparisons aren't particularly meaningful given the ramp-up phase that we're in for this business unit.

But generally, the revenue that we saw in the quarter was in line with our own expectations. Looking at profitability and EBITDA. The numbers we see, both for the quarter and year-to-date is strongly influenced by the phase that the business unit has been through, where we've invested a lot of resources in personnel and product development to get to the point that we are today. As revenues start increasing in the second half of the year, profitability should also improve. The CVIC funding that we got from Canadian -- the Canadian government that Morten mentioned will also help and will go towards actually lowering our operating expenses and thus increase EBITDA for this segment.

The impact of the CVIC funding to EBITDA in the second half of the year is expected to be up to approximately CAD3 million or NOK25 million and the remaining up to approximately CAD5 million or NOK40 million will be recognized in 2025 given that the full amount of funding is released. Zooming out again to the group level and moving on to our balance sheet. Total assets at quarter end was approximately NOK4.6 billion. On the asset side, the main meaningful change can be seen in property, plant and equipment connected to our capacity expansion program, as well as an increase in net working capital. The working capital position is a reflection of the rapid growth we've had for several quarters in a row as well as the ramp phase that BVI is in currently where we've had to produce certain items to inventory ahead of time before we're ready to ship trucks.

This mainly relates to the battery modules that goes into our battery systems. We also saw an increase in other noncurrent assets in the quarter. This is where our battery cell related prepayments to Panasonic sits and where the 2024 installment of NOK71 million was made in the second quarter. Our cash position at the end of the second quarter stood at NOK543 million. Moving on to the equity and liability side of the balance sheet.

There's no major changes at the end of the second quarter compared to the first quarter of the year. And our equity ratio stood at 40% at the end of the quarter. Looking at the cash flow statement, which reflects the movements in the balance sheet and P&L. Our operating cash flow in the quarter was minus NOK232 million. Operating losses before tax makes up the bulk of this at minus NOK224 million, combined with the mentioned increase that we had in working capital, which was NOK120 million in the quarter.

The main item under cash flow from investing, which totaled NOK180 million in the second quarter was NOK133 million we invested in property, plant and equipment. This was somewhat lower than expected, but should be caught up in the remainder of the year as we look to complete the capacity expansion program by the end of this year. We also settled the last and final part of the earn-out related to the Wystrach acquisition from 2021, which amounted to NOK43 million. Finally, net cash flow from financing was minus NOK10 million in the quarter. And the main items were repayment of lease liabilities and proceeds from a share capital increase that we did in the Chinese joint venture.

With that, I'd like to pass it over to Morten to walk us through the outlook.

Morten Holum

Thank you, Salman. I'd like to start the outlook section by repeating what I've said in the last couple of quarters because I think it's important to understand our overall plan to properly assess the performance and the execution of that plan. When we set off on this journey, our master plan was to build a business that could handle at least NOK5 billion in revenue and be able to generate solid profits and cash flow at that volume of business. We scheduled the plan in three phases, and we are more or less through Phase 2 with most of our activities now in Phase 3. We have validated our technology, the market and our competitiveness at Phase 1.

We have built the majority of the manufacturing and assembly capacity that we need at Phase 2. And we are now working on ramping up and filling that capacity with volume. We have solid gross margins on customer deliveries across the Company. So as we now grow volume, we will gain operating leverage, scale efficiencies, and we will ride down the cost curve and up the profitability curve. And you can see this clearly in our performance trends.

We are on track. Our financial targets for 2024 and 2025 remain unchanged. For this year, we target to grow revenue by at least 50% and achieve a significant year-over-year improvement in EBITDA margin. And for 2025, we target NOK4 billion to NOK5 billion in revenue and to reach breakeven at group level before we get to the end of that year. So what does the path towards those targets look like?

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Well, let's start with 2024. Putting the order backlog for the remainder of the year on top of the year-to-date revenue as of Q2, we have 90% of 2024 revenue target secured. And the remaining gap will be covered by call-offs under existing customer agreements and recurring customers. So I'm quite confident on the demand side. I don't really see demand as a constraint for '24.

The main focus will be to execute well on the orders that we already have, ensuring that we can ramp up our facilities and shore up the supply chain. And then we'll have special attention of course on getting a good start for the Hino and Daimler programs. The firm purchase orders for '25 has not yet come in, but everything I hear from customers signals that we should not be overly worried about demand and for call-offs under many long-term agreements that we have. I expect us to have a much better visibility on '25 a bit further into the second half as we progress the discussions with our hydrogen infrastructure customers for their '25 build slots. So looking at '25, we have two main segments, HMI and BVI.

The HMI segment is already EBITDA positive for the first six months of this year, and this should get better as we move forward. We have a competitive portfolio of industry-leading products. We have a strong customer base, solid gross margins and a brand-new manufacturing footprint. And remember, we're still in the early stages of our scale-up trajectory. So we have quite a bit to go on in terms of volume, in terms of scale and operational efficiencies.

So I'm confident that we will be able to continue to grow and improve performance in that segment. And then we have the BVI segment that has almost no revenue. So it's all cost at the moment. But also there, we have a unique offering with industry-leading technology, a strong customer base, a sizable contract portfolio and newly established manufacturing footprint. It's been all costs up until now, but we're just about to start generating revenue in that business, and this will grow quickly and significantly over the next 12 months.

And when we do, we will gain higher operating leverage to absorb fixed cost, and we will gain efficiencies and scale effects in operations and in the supply chain. This business will scale a lot faster than the HMI business. And also here it will likely be more a matter of execution than demand. So if we execute well and according to plan, we should get this to EBITDA breakeven by the end of 2025. So we are well on track and I'm confident that we will be able to reach our targets for both 2024 and 2025.

Our priorities are clear and unchanged. It's all about driving profitability. And for that, we need to continue to grow, of course, but we will be laser-focused on execution, ramping up the business as quickly as we can to maximize utilization of the newly installed capacity, driving operational improvements in our manufacturing processes and in the supply chain to drive down costs and increase our margins. And third, minimizing further capital spend beyond what we need to complete the last parts of the existing investment program. This should result in a meaningful improvement in profitability and capital efficiency.

We're laser focused on execution. And with a good first half of the year under our belt and a solid outlook for the remainder of the year, we're confident and we're on track. That concludes our presentation for today. And we'll now open it up for Q&A. Mathias?

Question-and-Answer Session

A - Mathias Meidell

Thank you, Morten and Salman. So, let's start. Let's kick off. There's quite a few questions, so let's get it going. So, the first question is from [Lars Vahanan].

What is the value of the contract with Toyota Motors North America?

Salman Alam

Yes, I can take that. So I think as Morten already mentioned, we're very happy with the collaboration and the partnership we have with Toyota. We've had that for several years. The program that we're on now is for the delivery of hydrogen storage systems and battery systems, which goes into their -- into the kit, fuel cell kit that they deliver to other truck OEMs. We haven't been explicit about the contract value for that contract.

But depending on obviously how the volume develops, we are -- our internal expectations is that it could be a contract in the hundreds of millions of NOK range.

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Mathias Meidell

Thank you, Salman. And then another question to you, Salman, from Helene Brondbo. "Can you provide some flavor to what is included in other operating cash flow of positive NOK62 million in the chart on Page 24 in the presentation? Yet it's outweighing the negative NOK71 Panasonic prepayment."

Salman Alam

Yes. Absolutely. So I think the other adjustments to the cash flow there, Helene, is typically net interest expense. So that was about NOK60 million in the quarter. And then you have FX translation.

And last, you also have other balance sheet movements, which doesn't have a cash effect, which shows in that line.

Mathias Meidell

Thanks, Salman. And then one for you, Morten. I guess you just mentioned in the presentation, but let's quickly repeat it. It's from [Robert Bulke]. "So ladies and gentlemen, could you please advise when Hexagon Purus will start delivering the Tern trucks?

And when this will begin to have a positive impact on profits. Overall, when do you expect the battery electric vehicle business to become profitable for your company?"

Morten Holum

Yes. Yes. So the BVI segment, we -- our overall expectation is that we will get that profitable by the end of next year. So now we build a -- we build a facility, we recruit people. We have spent a lot of time on product development and engineering and getting the product ready, also getting the supply chain put together.

The first trucks will be delivered in Q3, that will be trucks that's used for test and validation, of course, and then there will be demo fleets that will go to dealers so that dealers also can demonstrate the trucks to customers. And so through this year, there will be a, I would say, a rather small volume in the grand scheme of things that will be delivered for this year. And then next year, we go into the hundreds of trucks. And so the commercial production in larger scale that goes out to customers will be in Q1 and then ramping up quickly towards the end of the year. And I think as I mentioned in the presentation also, this business because of where we are and because of the volume expected and all the preparations we've done, this is going to scale a lot faster than the HMI business where we've spent a number of years now to prepare and scale that up.

So it's going to go a lot faster on the BVI side and will be EBITDA positive in that business by the end of 2025.

Mathias Meidell

Thanks, Morten. And then a question for you, Salman, from Martin. You had a negative from operating plus investing cash flow from minus NOK412 million in Q2, your cash position is NOK543 million. Will you need to raise cash in the near future? And if not, how long do you think that your cash will last?

Salman Alam

Yes. So I think to answer that question, we could also take a step back to when we announced the funding round last year, so the last funding we did. We said that the cash we raised in that round would take us through 2025. That's what we're still seeing. But if you look at the cash balance, as you point out, as per the second quarter, it's not unreasonable to think that the capital raise could take place in the second half of this year.

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We are obviously in close dialogue with our strategic partners on this topic and our key stakeholders, and we have a plan in place that we are confident that we will execute on.

Mathias Meidell

Thanks, Salman. And two short follow-ups from Martin. You talked about getting EBITDA positive in 2025. When will you get cash flow positive? And can you give a CapEx number for the second half of '24.

Salman Alam

Yes. So I think on the first point about cash flow positivity, it's a good question and it's also a bit of a relative question because it obviously depends on how much you want to grow in the future. I think as Morten and we already mentioned that in today's presentation, we're really focused on getting our current capacity expansion footprint in place and not embark on any large investment programs beyond that for now. So there are scenarios, obviously, that we're working on internally that implies that we could be cash flow positive towards the end of 2026 or early 2027, but it does depend obviously on the circumstances and other.

Morten Holum

I guess it depends on how much growth -- additional growth that we spend cash for. So looking at the footprint that we've now built, that's built to be profitable and to generate cash. And it will do that when we get into '20 -- yes, late in '26, we will likely be cash positive if we don't take additional investments to expand further. And so we have rigged this to be a good business at the size we are now, -- and then if the exciting opportunities are coming further, we can take that discussion when we get there.

Mathias Meidell

Thank you. And then a question from Thomas Martin. "Backlog. Do you intend to provide intra-period or inter-quarter updates on customer call-offs for trucks as they arrive with monetary values?"

Salman Alam

Yes. I think Thomas it's a good question. Obviously I think as we get into the pattern of delivering these trucks, you could call these call-offs more of ordinary course of business, which wouldn't necessarily need to be disclosed. But I think there is merit to maybe disclosing the initial or the first couple of ones that we get just to signal that the ball is rolling. So that is something that we will consider.

But after a while, that obviously becomes ordinary course of business, which don't necessarily needs to be disclosed.

Mathias Meidell

Thank you, Salman. And then --

Salman Alam

I think also just I forgot or didn't touch on the CapEx question from Martin.

Mathias Meidell

Yes.

Salman Alam

So I think if you go back to what we communicated at the beginning of this year around the CapEx program, we foresaw to spend the last 30% of our CapEx program this year. So if you remember, that program was about NOK1 billion in total, 30% of that for this year. So that's NOK300 million. And then on top of that, we said that we would estimate to spend in the range of $20 million related to the Dallas facility to get that up and running for the Hino and Daimler program. So north of NOK500 million in CapEx this year.

That's still the number that we're seeing and that we are operating with. If you look at the CapEx that we had in the first half of this year, there will be CapEx also taken in the third quarter, and then we will expect to taper down in the fourth quarter as we move along the year.

Mathias Meidell

Yes. Thank you, Salman. And then we've gotten several questions on China and the development there. So if you could just provide an update on where China is now in terms of the process we're in, how the revenue would ramp up and how do we overall see the development there?

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Morten Holum

Yes. So in China, we have constructed the facility. We have gotten the machinery running and producing the first cylinders on that. And then we are working on getting local approval for the Chinese market and the certification process there is quite long. I don't expect us to have any meaningful volume out of China for this year.

But I do expect that we will see volume in 2025. And then it's a matter of following normal ramp-up curve for the facility. And again, I think it's -- China is a -- it's a very active market on the hydrogen side. I think looking at the grand scheme of things, a lot of things are happening. And so we are quite excited about the opportunity that is there in China, and then we'll have to see working on getting the certification and then our factory is more -- less ready to produce.

So we will see volume next year. And then yes, it will likely take at least a year to fully ramp up that line.

Mathias Meidell

Yes. Thank you, Morten. And then another question here from Martin on backlog. "The order backlog has decreased in the second quarter. Do you see any reasons that you are running into a long-term trend of decreasing orders?"

Morten Holum

No, I don't see that. And as I mentioned on the -- earlier as we went through the presentation, there is a natural reason why the order backlog is shortening. In the beginning, when we started, for example, let's take the -- let's take where we've had the longest horizon on orders. That has been on the hydro distribution side. And so go back two, three years, we were still working with customers on developing the standard module for them.

So we needed time in order to do that. So customers for that reason needed to order early, also needed to order early because the capacity we had was limited. So we needed to secure build slots. And we had a supply chain which had significant challenges as part of COVID. So in order to secure that we could deliver, you needed to put your order in quite a bit in advance.

Now we're getting more into running operation in that business. So again, together with our large customers, a lot of that is now standardized. So it's off the shelf. They put in an order, we manufacture it and then we deliver it. So that pushes down the lead time, which again, as I said earlier, is a big benefit actually for customers, and it's a big benefit for us just being able to do our standard work.

And then of course the side effect of that is that the visibility of the backlog on the long end decreases. But I don't think there's any reason that we should worry about this. We also have dialogues with the customers. So we talk a long time ahead of time with what they are foreseeing to order, which is -- it's normally in an OEM business and in the mobility business. You have these -- you plan for capacity and then you get call off orders from the long-term agreements that you have.

So it's not normal to announce a big order long time ahead of time. We announce the contracts when we get them, so a long-term agreement, and then the call-offs come when they come, so. And that of course is an issue for -- in terms of interpreting the order backlog. But we are a bit different than many of the other companies in this space who has a lot of customization and has a lot of bigger type of equipment that you make. So you typically there have orders a year or two even in advance.

So we're fairly confident, everything I hear, as I said, from customers signals that we should be quite confident about demand.

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Mathias Meidell

Thank you, Morten. And then a question for you, Salman, from Thomas Martin. Once ramped up, can you please describe the relative EBITDA margins you expect to deliver across hydrogen infra, H2 mobility and BEV mobility? Do you think about the expected margin for vehicle integration separately from provision of H2 and BEV mobility solution? Or is it an integrated part of it?"

Salman Alam

Yes. Yes. So I think maybe if we can kick off at sort of at a higher level. So Thomas, long term, as we've talked about previously as well, our ambition is to reach double-digit EBITDA margin around -- at least around the 15% level. I think if you look at the two business units that we have, so the Hydrogen Mobility & Infrastructure business and the BVI business, we are currently expecting the HMI business to be somewhat north of that target.

And then the BVI business to be somewhat below that target. So that you blended as a group, come to that 15-plus percent range. I think when it comes to thinking about the profitability of the vehicle integration business, we think of that as a -- with the current business model that we have, as a combined part of the battery systems and vehicle integration business as we are in the business now of delivering complete battery electric trucks.

Mathias Meidell

Thank you. And then a follow-up question on Toyota. "You just said" -- it's from Martin. "You just said the Toyota contract will be in the hundreds of millions NOKs. Did you really mean NOK or did you mean dollars?"

Salman Alam

Yes, I meant NOK.

Morten Holum

Yes, yes.

Salman Alam

Yes.

Mathias Meidell

And then a question from Elliot Jones here. "Congrats on the great set of results. In the Hydrogen segment, is it fair to assume continued EBITDA positivity through the year alongside the increased manufacturing capacity at Kassel?

Salman Alam

Yes, yes. I think at the current revenue level, Elliot, and with the current product mix that we are seeing, as long as it stays above that level, we do expect to be EBITDA positive. Obviously, there will be quarterly fluctuations. We're still in ramp-up mode, we're still in a very fast growth environment. So there will be -- there may be quarterly fluctuations there.

But we generally do expect the -- now to be past the point of EBITDA breakeven and to report EBITDA positivity from here on out. Yes.

Morten Holum

I think fundamentally, we are still early out let in the overall ramp-up curve. So there's a lot of things that we can do to improve profitability of what we do even at the level we are at now. So I'm quite confident that we, over time, are going to be able to drive profitability up in the HMI segment.

Mathias Meidell

Thank you. And then a question for you, Morten. "What are your expectations short and long term when it comes to Cryoshelter?"

Morten Holum

I think for -- in the grand scheme of things, I think there is potential out in the future for liquid hydrogen. And so we want to stay on top of that and understand what it is. But at this moment, it's more development work. And again, we're really laser-focused on execution on the businesses that are here now today, that's our main focus. We still keep our chips on the table when it comes to liquid hydrogen.

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It's going to be -- in any meaningful volume, it's likely past 2030. But I think it's an interesting technology. And so it's worthwhile for us to also keep tabs on that by having a stake in the Cryoshelter business.

Mathias Meidell

Thank you. And then another question from Martin here. "You now have 129 employees in the BVI segment. How do you expect that number to deliver until the end of 2025? Will you need to double it somewhat I guess?

Salman Alam

Yes. I think the majority of that 129 people, as you point out, Martin, is primarily, right now primarily engineers and primarily SG&A staff. We have this year, so far this year also increased a bit on the direct labor side. But going forward, we will probably have to increase that portion of our FTEs quite significantly to deliver on the volume ramp-up obviously. I wouldn't necessarily say I expect it to double by the end of 2025, but it will be significantly higher probably than it is today.

Yes.

Mathias Meidell

And then another question from Martin here. "Which segment in the HMI segment do you see as most promising and which one is perhaps lacking a little bit, if any?"

Morten Holum

Yes. So I think they're all promising, right? So hydrogen infrastructure is here today for natural reasons. So that's a segment that has shown a lot of promise for a while and are now being demonstrated in terms of quite high growth. I think the hydrogen transit is also well underway.

The heavy-duty truck side of things is a little bit behind, and it's again the infrastructure and the green molecule availability that is hindering a mass adoption of heavy-duty trucking for hydrogen-powered heavy-duty trucking. But it's very logical and a very exciting segment for the future. It's clearly now proven with the trucks that are on the road, how superior this technology is for those long heavy-duty cycles. And so I think that has -- whether you call it lagging, this is a very exciting area that is early stage. I also see a lot of promise for the maritime segment, for rail, although these are also a bit further out in time.

So there are exciting things ahead of us. But then I also think that it's important to keep in mind that take a look at the size of business we are and the Company, the footprint that we have built. We don't need mass adoption of anything like this in order to fill our facility. And the nice thing with our business model is that we have an opportunity to collect volume from many different segments and still get now meaningful scale in our own operation. And then if you get closer to a mass adoption point later on, yes, we have an ability to very efficiently increase the size of our footprint.

But for now, this is a bit the future. Now we're talking about what we have here and now. And so yes, that's where we are.

Mathias Meidell

Thank you, Morten. And then a question for you, Salman, from a private investor, undisclosed name. "Are all major customers paying their invoices on time?"

Salman Alam

I would say generally yes, we are comfortable with the level of accounts receivables that we have outstanding and also the aging profile of those receivables.

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Mathias Meidell

Good. And then a question for you, Morten, that I think you've touched upon earlier as well, but it's from Martin. "Where do you see the more revenue potential for your company, in the battery truck segment or in the fuel cell truck segment? And which technology do you think will succeed in the truck business in general?"

Morten Holum

Yes. So the way I see things, it's fairly simple. You have these technologies, the battery electric technologies and the hydrogen electric technologies. They are -- well, both of them are electric technologies or electric-powered trucks. They are -- they will both be needed.

They have different strengths and different characteristics which makes them usable for different segments. So my answer is always both. You need both technologies. So -- and I think that when we look now, most of our business is hydrogen-driven we have now start delivering on these fairly large battery electric programs, which means that we will scale that rather quickly. So looking into next year and 2026, you'll start to see a much larger share of battery electric volume in our business.

And then who knows what '28 and '29 looks like. So we are focusing now on the, again, the footprint that we have, getting that optimal, make sure that we generate profits and cash, and it will be a lot more balanced than what it is today. It will still be, I think, higher hydrogen volume in total when you count in the infrastructure business than on the battery side. But on the vehicle side, if you just talk heavy-duty trucks, it will probably be battery electric dominated in the early years until you get the good momentum on the hydrogen side. Just given the nature of the contracts we have.

Mathias Meidell

Thank you, Morten. And then there are some couple of questions on hiring, both in Germany and the U.S., you covered BVI, Salman, but maybe you could just touch upon a bit on sort of the HMI segment as well, how the expected growth in employees are there.

Salman Alam

Yes. I think generally we've spent the last couple of quarters and years getting the SG&A, especially the SG&A backbone ramped up and improving, getting the people that we need to run this business going forward. So a lot of those investments are behind us. I think where there will be more people come in is more on the direct labor side, especially we talked about Dallas already, but to be able to process and output the increased volume that we are that we are seeing. We're not seeing any big increases at the corporate HQ.

We are not seeing other large increases in SG&A.

Morten Holum

You don't find any golden toilets in our headquarter. We're fairly small and -- but very, very good team. And this team is able to handle a much bigger volume. That's part of the benefit of where we are now is that we've actually taken a lot of the fixed cost investments that we need to take. And then now as we get volume, you get a lot higher absorption of those fixed costs, and that enables you to run much quicker up the profitability curve.

Mathias Meidell

Thank you. And then another question from Thomas Martin here, Salman. "Can you provide an update regarding which cost elements are expected to see the most significant increases as you ramp up the businesses on Daimler and Hino? [Eg], what is your current view on the sustained longer-term payroll cost as a percentage of revenue. Where do you expect other operating expenses to level out?

Presumably, cost of material is expected to remain around 60% level?"

Salman Alam

Yes. Yes. I think on the last point there, Thomas, we are seeing -- at least for this year we are seeing the cost of materials average out at around 60% so that we're still seeing that it will fluctuate a bit from quarter-to-quarter, but that's overall for the year what we're expecting. I think in terms of the sort of the longer-term trends when it comes to other operating expenses, payroll as a percentage of revenue, those numbers will decline, and they will get lower than they are today as revenue increases. Revenue will increase more than the expenses will.

And then there are some divisional differences here, obviously, which we can also maybe get back to off-line to help you model that in the best way.

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Mathias Meidell

Thank you. And then a question for Morten here. "Do you explore any other way to get more cash besides doing capital raise, i.e., long-term credits? What's your preferred way to raise cash?"

Morten Holum

I think we can't comment specifically on that topic. But what we can say is that both management and the Board is assessing different alternatives. So I think that's what we can say.

Mathias Meidell

Thank you, Salman. And then another question. "Taking your factories that are up and running and the ones you have planned, what is the annual revenue potential with these factories?" I guess you touched a bit upon it in the presentation.

Morten Holum

Yes. So the footprint was geared to handle at least NOK5 billion in revenue, and there is a reason for that NOK4 billion to NOK5 billion target that we set for ourselves. So the overall capacity needed to be above NOK5 billion. It's a bit higher than that. So we have an ability to grow even beyond the NOK5 billion naturally.

And it depends on -- it depends on a lot of things actually, but I think you can at least take a 20% plus on top of the NOK5 billion in terms of what our maximum capacity is going to be.

Mathias Meidell

Yes. And then another question from a private investor. "Can you reiterate the commercial model for Tern? It's a H Purus brand. Hino is providing service and sales.

What companies counterpart for the end customer, who is paying H Purus, who's paying us?"

Morten Holum

Yes. So again, we have a distribution agreement with Hino trucks, right? So we get a chassis from Hino, we electrify the truck, and we sell it back to Hino who sells this truck through their dealer network and who does all of the aftermarket service and support, it's done by Hino. And so our counterpart is Hino, we sell it to them, they sell it further on to their customers.

Mathias Meidell

Thank you, Morten. And then one more question here from Thomas. "I appreciate you haven't given post-2026 guidance. But if you aim for breakeven in 2025 and are not investing in additional capacity in near term, does that suggest 2026 might be similar to Q4 2025 annualized? What is your expected margin delivery from the current capacity base ones ramped up?

Morten Holum

Salman?

Salman Alam

Yes, I can take that. So I think, Thomas, we are definitely also seeing growth in 2026. As Morten said, the current capacity footprint that we are installing, that we have installed will have a revenue capacity that exceeds that NOK4 billion to NOK5 billion target and can also take us to the growth that we're seeing for 2026. So there will still be growth in '26 and annualized Q4 '25 may be on the lower end of at least our expectations. I think margin-wise, we are expecting obviously '26 then to be -- to have a higher margin than '25 as that's the point we get breakeven.

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But we will come back to the 2025 and obviously also the 2026 outlook at a later point in time.

Morten Holum

There is good growth opportunities for us going forward. And we are focused now on optimizing the footprint that we have, getting that profitable and getting that cash generative. And then as we have built somewhat bigger suit than what we need at this point, any further increases in capacity can be slotted in much cheaper and much quicker than the capacity that we've now built. So, we've kind of kept the opportunity to be able to grow quicker if there is a clear business rationale for that. But if we don't, we still have an opportunity to grow quite a bit and to generate profits and cash at the level we are at now.

Mathias Meidell

Okay. Thank you, Morten and Salman. That wraps up the questions that we have gotten here today.

So, with that, I would like to wish you all a great summer. And I would thank you for paying attention today. So, thank you again.

Morten Holum

Thank you.

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