

# **Hyliion Holdings Corp. (HYLN) Q2 2024 Earnings Call Transcript**

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**Body**

Hyliion Holdings Corp. (HYLN)

Q2 2024 Results Conference Call

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Company Participants

Greg Standley - Chief Accounting Officer

Thomas Healy - Chief Executive Officer

Jon Panzer - Chief Financial Officer

Conference Call Participants

Donovan Schafer - Northland Capital Markets

Presentation

Operator

Good morning. My name is Emma, and I will be your conference operator today. At this time, I would like to welcome everyone to the Hyliion Holdings Second Quarter 2024 Earnings Conference Call [Operator Instructions]. At this time, I'd like to turn the conference over to Greg Standley, Chief Accounting Officer. You may begin.

Greg Standley

Thank you, and good morning, everyone. Welcome to Hyliion Holdings second quarter 2024 earnings conference call. On the call today are Thomas Healy, our Chief Executive Officer; and Jon Panzer, our Chief Financial Officer. A slide presentation accompanies this conference call and is available on Hilyon's Investor Relations Web site at investors.hyliion.com. Please note that during today's call, we will make certain forward-looking statements regarding the company's business outlook. Forward-looking statements are predictions, projections and other statements about anticipated events that are based on current expectations and assumptions. As such, are subject to risks and uncertainties. Many factors could cause actual results to differ materially from forward-looking statements made on this call. For more information on both factors that may cause the company's results to differ materially from such forward-looking statements, please refer to our presentation and press release as well as our filings with the Securities and Exchange Commission. You are cautioned not to put undue reliance on forward-looking statements. And we undertake no duty to update this information unless required by applicable law. Thank you. I will now turn the call over to Thomas.

Thomas Healy

Hello, and thank you for joining us for Hyliion's second quarter 2024 earnings call. Today, I am joined by Jon Panzer, our CFO. Over the past quarter, we've continued to make great progress with the commercialization of the KARNO generator and are continuing to build strong customer interest. This progress includes building a backlog for 2025 shipments, exploring applications in new target markets and receiving positive customer feedback highlighting their growing need for more power. We believe the KARNO generator can provide transformative power generation technology to address these ever growing needs. I'd like to start the call off with an update around our planned deployments for the quarters ahead. We have signed letters of intent with customers for all of the units we plan to deploy this year. These early units will be deployed into various target markets and some with select Fortune 200 companies. As we look ahead at 2025, I am pleased to share that we already have letters of intent with customers for over 50% of units that we plan to deploy next year. We plan to disperse these units across a diverse set of customers that operate in many of the markets that we are targeting. As we shared on our last earnings call, we anticipate these shipments to generate revenue in the low double digit means of dollars.

Included in this growing backlog for next year are two customers that we recently announced, US Energy and Flexnodes. US Energy, a division of US Ventures, Inc. is a leading provider of refined products, alternative fuels and environmental credits. Within their portfolio of companies, they own and operate natural gas and RNG fueling stations across the US. The LOI that we executed outlines plans to deploy a KARNO generator at one of their fueling stations to provide electricity to operate the station and ancillary equipment, such as pumps and compressors. We also executed an LOI with Flexnode, a digital infrastructure company that specializes in building cutting edge high performance data centers that simplifies the design and deployment. Flexnode has created a scalable data center solution that can be deployed at existing facilities or leverage existing infrastructure. One of the challenges faced by their customers and the industry broadly is finding reliable sources of clean power for these megawatt scale data center solutions. Flexnode plans to integrate up to 10 KARNO generators starting next year to help solve this problem. By coupling a scalable data center with scalable power generation, we are enabling a solution that can be easily deployed and tailored to customers' needs. Please note that the letters of intent that have been executed with customers are nonbinding and these deployments are subject to the execution of definitive sales agreements.

I'd now like to provide an update on the power generation market landscape. Over the past couple of quarters, we've had dozens of customer discussions and have continued to learn more about potential market opportunities for the KARNO generator. We have received overwhelmingly positive feedback from these potential customers. They see the KARNO generator as a revolutionary generator that is poised to overcome many of the conventional hurdles of on-site power generation. Key attributes include the KARNO generator's expected high efficiency, which equates to a low cost of electricity, low maintenance requirements, lower emissions footprint and versatility of being able to operate on many fuels. Based on customer feedback, we've made a couple of updates to our target markets infographic that we shared a few months ago. The first is with regard to data centers. As we've met with numerous companies in this space, it has become apparent that this market can become a key focus vertical for us. We've heard strong feedback that the AI boom is demanding significantly more data centers, which, in return, requires significantly more power. KARNO generators with their expected fuel flexibility, high efficiency and modularity can enable data center operators to generate their own power using pipeline natural gas or other low carbon fuels and then seamlessly switch to on-site fuel storage, such as diesel or propane in case of emergency or pipeline failure. Such flexibility will enable these customers to use the KARNO generators for meeting both baseload generation and resiliency needs at a facility.

Another vertical we have added is waste heat utilization. Manufacturing operations for steel, aluminum, glass and many other products generate a significant amount of heat that is released into the atmosphere as waste. We are presently in early discussions with a few manufacturers in these industries to explore the opportunity of utilizing their waste heat as a fuel source to power the KARNO generator. Unlike conventional generators that utilize fuels like natural gas or diesel to move the mechanical parts of the engine, the KARNO generator is powered by heat. In most applications, the KARNO generator will use fuels like hydrogen and natural gas to make the heat that will directly power the KARNO generator. However, if an application already generates heat, we are exploring redirecting that heat to power the KARNO generator. This would significantly reduce, if not eliminate, the need for conventional fuels like natural gas or hydrogen, which could dramatically lower operating costs. In another recent development, we've been awarded a small business innovation research grant from the US government. We are excited about this opportunity to focus on the development of a multi-megawatt package KARNO generator for US Navy applications. We'll plan to share more on this opportunity in the near future.

I'd now like to shift and share some more updates on the progress we've been making on the development of the generator and our production capabilities. Over the past quarter, we've continued to test the alpha version of the generator and are preparing the beta version for customer deliveries later this year. Over the past quarter, we focused on testing many of the improvements that we are making in the beta generator to ensure it operates and performs as we expect. We've also continued to refine and improve the production of beta components on our additive manufacturing machines. Because of this ongoing work, we are not yet checking off the box, indicating full completion of beta development in the first half of this year but we do expect to complete the final two milestones by the end of the year. In Q2, we also focused on expanding our production capabilities in Austin. We now have additive manufacturing machines printing components around the clock. We also have more additive machines on order from General Electric that we are installing between now and early next year. These new machines will support the production ramp-up anticipated for next year. In conclusion, we continue to make great progress towards and remain on track with our key objective of getting initial early adopter customer units deployed by end of this year. We are also excited by the discussions we are having with customers and believe that the KARNO generator will address the key pain points they are facing as they search for additional sources of power generation. We believe this puts the company in a strong position for ramping up production as we head into 2025. I'd now like to hand the call over to Jon to cover some financial updates from the quarter.

Jon Panzer

Thank you, Thomas, and good morning, everyone. Operating expenses for the second quarter were $14 million compared to $38.5 million in the second quarter of 2023. This decrease in expenses is related to the wind down of our powertrain business, partly offset by an increase in KARNO spending this year. During the quarter, we recorded a $600,000 credit in powertrain exit and termination expenses, which was driven by the sale of certain assets of the discontinued powertrain business, partly offset by ongoing shutdown costs. Our total net loss in the second quarter was $10.9 million, down from $35.2 million in the second quarter of 2023 and down from the $15.6 million loss we reported in the first quarter of this year. The sequential decrease in net loss this year was related to fewer charges for powertrain wind down activities. Year-to-date, operating expenses totaled $33 million compared to $70.4 million in the first half of 2023. Expenses in 2024 include $3.9 million of powertrain exit and termination costs net of asset sales. The wind down of powertrain has largely been completed except for our ongoing efforts to monetize assets, which we expect will yield additional income and cash in the coming quarters. During the second quarter, we repurchased 1.9 million shares of common stock for $2.7 million as part of the $20 million share repurchase program we announced late in 2023. The average purchase price per share was $1.45. Since program inception, we repurchased 10.6 million shares for an aggregate cost of $14 million, resulting in an average purchase price of $1.32. As of early May, we suspended share repurchases due to the recent strengthening of our share price and do not expect to execute upon further repurchases, but may resume repurchasing activity at a later date if and as deemed appropriate.

Turning to our cash position. We finished the second quarter with $249 million of cash and investments on our balance sheet. We utilized $15.2 million of cash and investments as well as previously restricted cash in the second quarter of this year and $50.6 million year-to-date. Breaking down uses of cash for the year thus far. Spending on core KARNO development activities totaled $27 million, including capital investments of $8.1 million. Capital investments were directed mostly towards the purchase of additive printing machines and related equipment. In addition to the $14 million spent on share repurchases, we also spent approximately $10 million on powertrain shutdown activities, net of asset sale proceeds. Looking forward, we expect to begin deploying KARNO generators units to customers late this year. While these are expected to be paid deployments, the timing of the payments to Hyliion will likely extend into 2025, depending upon the commercial terms agreed to for the initial deployment agreements, the time required for certification and permitting of the generators as well as achievement of operating performance criteria. We expect to grow deployments in 2025 and to begin recognizing revenue for sales to customers once our development work is complete and we reach the commercialization milestone for the KARNO generator. We are maintaining previous guidance that we expect revenue in 2025 to be in the low double digit millions of dollars.

As volume grows, we expect to realize production cost efficiencies, particularly for purchase components and services needed to build the KARNO generator. Initially, we expect gross margins to be negative but also to improve quickly as we realize scale efficiencies and production and purchasing. We are currently targeting gross margins to be approximately breakeven measured on a cash basis by late 2025 or early 2026. Beyond that time frame, we haven't yet developed a firm forecast. We now expect that total cash expenditures for our KARNO generator business in 2024 will be approximately $55 million compared to our previous estimate of nearly $50 million. As a reminder, our cash forecast includes operating expenses, capital spending and interest income, but excludes cash spent for share repurchases, powertrain shutdown activities and asset sale proceeds. This higher estimate reflects a more rapid ramp-up in additive printer growth investments in Texas that Thomas referenced earlier in the call and could fluctuate up or down based on the timing of printer deliveries that we currently have on order. Finally, we expect that the capital we have on hand today will be sufficient for the foreseeable future, including commercialization of KARNO generators sales. Now I'll turn the call back over to Thomas.

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Thomas Healy

Thank you, Jon. Before transitioning over to Q&A, I'd like to share a quick recap of the quarter. We've been making great progress with the commercialization of the KARNO generator which is keeping us on track for initial customer deployments this year. In parallel, we've been building our backlog of interest, expanding our target markets and already have LOIs in place with customers for half of the volume we plan to deploy next year. Thank you for your ongoing support and interest in Hyliion and I'd now like to open the call for Q&A.

Question-and-Answer Session

Operator

[Operator Instructions] Your first question today comes from the line of Donovan Schafer.

Donovan Schafer

So first, I just want to start off. I can't remember if we've covered this before, but can you give us any numbers or any kind of just like quantification around the number of units when you talk about 2024 capacity as fully booked and 2025 -- 50% of 2025 capacity fully booked. Is there any number or anything you can point us to in terms of the number of units that can help us orient what that means. And in terms of units, clarify whether you mean like a generator, you've got four cylinders or systems or whatever, or just -- so that there's not an ambiguity there either?

Thomas Healy

So this year 2024, it will be in the single digit units. And to your point there, it is complete gen set. So it would be the 200 kilowatt, the beta design of the system. So I mean these are really just the initial units getting them out into customers' hands, Donovan, as we've spoken about. I mean the goal is -- we've got very collaborative agreements with these early adopters where as they're signing up for working with us, providing feedback, giving us advice suggestions on how those system is performing. And we have the ability to come back and if any changes are needed to be able to implement those. And that really tees us up for really hitting commercialization of this solution in 2025. Now what we've said is, in terms of volume for next year, we've really targeted more of a revenue number and that's going to be in the low double digit millions in revenue for next year. We haven't yet correlated that back to an actual number of units. But we're pleased to share on this call that to hit those -- that milestone I mentioned, we've already secured more than half of the backlog that we would need in order to be able to achieve that for 2025.

Donovan Schafer

And just trying -- are you saying low single digit, high single digit number of generators for kind of more than five, less than five or for this year? And is that right, where that corresponds -- so the logic would be if it's something north of five and then that implies something in the teens or something for 2025, like capacity, or do those things not quite connect that way? And again, high single digit or low single digits.

Thomas Healy

So for this year, I think it's in that mid-range of single digits. And then as we look at next year, much more than in the teens as you were expressing in terms of generators. We just haven't correlated that to an exact number of units, but 2025 is really that commercial starting getting volume out there by the end of '25, having a very strong deployment of many generators out there in customers' hands.

Donovan Schafer

And then as a follow-up, talking about mostly data centers but also cryptocurrency at all is kind of heavy overlap there. But data centers, mostly people are talking about the AI stuff right now. And talking to Generac and some other companies, it sounds like footprint is a very important consideration. And in their case, a lot of times they're looking at offering just the backup generators. So looking at data centers where there's going to be some kind of a grid tie, grid connection. And then you have this backup functionality that kind of has a superfluous use, you're kind of hoping you almost never have to use it. But with natural gas -- conventional natural gas generators, I think they have a much larger footprint than you're able to pack in a lot more like diesel generators and things like that. And so it seems like that's become an important consideration. So I'm curious, how does the footprint for the KARNO generator compares to kind of those conventional offerings? And I'd say on an all-in basis, right? So if you are talking about using gas or alternative fuels in a backup application like you're not going to have -- they're not going to pay the money to have a large, like hydrogen storage tank plus a large paid storage tank plus all that stuff. So like how do they look at it from a footprint standpoint and are they mostly looking for prime power or for backup?

Thomas Healy

So great questions, a lot to unravel there. So let me first start with what data centers have been doing in the past. And that is conventionally they use the grid as their primary power source and then they deploy a bank of diesel engines there that are just there for emergency standby power. With this recent AI boom and also the improvements with kind of the processing power of computers, there's two new issues that are coming about. So the first is they're finding that the utilities just don't have the amount of power available that they need. And then the second is as they go and upgrade data centers and new processors are a lot faster, but they also consume a lot more power, they're finding that the grid used to be able to provide enough power. But with these new machines now that same data center requires a lot more power consumption and the grid is not able to supply it. So now that's where data centers are starting to look at actually using on-site power generation and that's where natural gas engines, as you pointed out, come into play. So footprint is a major issue.

And even so, what we're now hearing from customers is -- we actually just had a customer a couple of weeks ago and we were talking about how in Ireland, there's a new data center being built and they actually have natural gas engines deployed for prime power. And then they also have a bank of diesel engines deployed for backup power. So that then even becomes a larger issue from a footprint standpoint, because now you have two sets of engines for that data center. So where we see the KARNO really fitting in is since we offer that fuel flexibility, we can be your prime power solution running on natural gas or hydrogen. And we can also be your backup power solution and you can have an on-site diesel storage or an on-site propane storage that, that same generator solution could run on those various fuels. So that's where we see data centers becoming a really big play, because we were enabling them to have a prime power solution that has low maintenance but also be that backup power solution as well.

Donovan Schafer

And if I can just squeeze one more question in. With the increase in guided spending for 2024, I guess the main question is just what the drivers of -- so I guess, first, I'm interpreting it, in the release, you talk about it as a more rapid build-out of additive capacity. So I think of that as sort of an acceleration versus some prior existing plan. And so if there is this -- if it is an acceleration versus what was prior planned previously, what the driver of that acceleration is? Is it opportunism around pricing of equipment in some spaces like in EV manufacturing? Other companies have talked about being able to scoop up equipment on the cheap. I don't know how much additive printing stuff is involved in that. So is it opportunistic with lower pricing for additive printing or is it more -- getting feedback from customers, it gives you more confidence and makes you want to accelerate. Just whatever the driver there is? And if you can confirm that it's an acceleration versus the prior plan?

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Jon Panzer

So it's a little bit of all of the above, I would say, it's certainly driven by capital investments pretty much entirely the increase in spending since our initial guidance. And it's really about trying to get the Texas facility built out, which is going to be our primary production facility over time. And it's also taking advantage of opportunities to buy both new and used machines that we found in the marketplace. So as we are getting very close to our initial deployments, we really thought about our ability to ramp up production next year and really taking advantage of all the opportunities to get capacity here. And so we're trying to make various decisions about used machines, new machines. In fact, all of that is playing into really the uncertainty about how many units and being more precise about our forecast for volume next year is because those are moving parts. Even our capital forecast this year could vary a little bit just depending on the timing of the deliveries and so forth between this year and next year. So it really is about capital and just trying to ramp up the Texas facility more quickly.

Operator

Prior to today, the company fielded questions from investors. I will now turn the call back to Greg to review those.

Greg Standley

Thank you. The first question. Are there two versions of the KARNO generator, alpha at 125 kilowatts and beta at 200 kilowatts and what are the differences between them if there are two versions?

Thomas Healy

So I wouldn't look at it as having two different versions. It's more the evolution of the development of the generator. So in terms of customer deployments, the only solution will be deploying with customers is that 200 kilowatt solution, the beta design that we'll be getting out into customers' hands later this year. Alpha was a version that we started working on back actually for the truck solution, which, as noted, is 125-kilowatt capable generator. And that's a solution that we've had operating for more than a year now. We've been going through the development, testing and iterating it. And the 200 is really just an evolution of that design. Actually, the size, the scale of the generator is the physical footprint is almost identical. But what we've been able to engineer is to actually have more power density, get more power out of the same footprint and as well as making other design changes and improvements as well. So in terms of customers, though, it's that beta design, that 200-kilowatt solution and that's what we'll be selling.

Greg Standley

You mentioned that the company is targeting to be gross margin neutral on a cash basis by late '25 or early 2026. Can you share what needs to happen over the next 12 to 18 months to achieve this?

Thomas Healy

So as you would expect, when you have a new product in the marketplace, your initial production costs are going to be relatively high as they transition from prototype scale to more higher production scale. So we're experiencing that right now. Our first units are going to be costing a little bit more than we expect over time. But we do expect cost to come down quite rapidly and ultimately get to the point over the next 12 to 18 months where on a cash basis that we're getting close to breakeven between the price that we're charging and the cost of producing the product. And again, what I mean by cash basis, that would exclude our overhead costs and warranty costs. So it's, again, kind of a normal trajectory that you would expect in manufacturing where costs are initially high and they come down rather quickly with production efficiencies and purchasing efficiencies.

Greg Standley

Can you further explain why the completion of data development was not completed in the first half of the year, and will this impact customer deliveries?

Thomas Healy

So as we've previously shared, we had released the beta design and we've been moving that into production and testing out those components. And the reason we didn't check the box on the beta development is, as we moved some of the components from kind of design into production, we saw that there were some areas where we need to iterate and change the design, improve the design. And so that's some of the undertaking we've been doing over the last couple of months. Now I think the key thing to note here is even though the beta production development is not done, we are still on track for having units out into customers' hands later this year. And one of the things that we've actually done to mitigate risk is some of the major design changes or improvements as you go from alpha to beta, we've actually made those changes in the alpha variant to the generator. We've tested them, we've proven the design work and that's going to derisk the launch of the beta product. So we're not comfortable yet checking the box on having beta development complete, just because a few of those parts we did kind of take them back through making design improvements from learnings that we saw from the productionization of the units, but we don't see that impacting our overall goal of getting units out to customers this year.

Greg Standley

And finally, can you further explain what an LOI from a customer is and what the difference between it and a definitive agreement, and at what stage with these deployments, do you plan on starting to recognize revenue?

Jon Panzer

So an LOI, a letter of intent with customers is really based upon the conversations that our commercial team has had with customers and what is included when we sell them a KARNO unit. So it has expectations on the performance of the units. It also includes pricing and other things that have to be -- that are ultimately part of what is ultimately delivered to the customers. Over time, we will be creating definitive agreements or more contractual agreements with customers for the sale of these units. And then regarding the revenue recognition, once those performance obligations and definitive agreements are achieved then you can start to recognize the revenue from the customers and ultimately, we'll be achieving that revenue recognition milestone that we expect next year sometime as we finally get past all the beta development and get to our commercialization milestones. So that will likely be next year.

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Thomas Healy

So that concludes the questions that we had fielded prior to the call. So just in closing, I want to thank everyone for joining our Q2 earnings call. I think this past quarter, we had a lot of success, especially on the market adoption side of things, as mentioned, having all the units committed for this year, having more than half of the backlog already identified for next year, that puts us in a very strong position as we go into the commercialization of the solution. And we look forward to getting these units out into the field later this year. So thank you again for joining the call and we look forward to talking again next quarter.

Operator

This concludes today's conference call. You may now disconnect.

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