

# **Nel ASA (NLLSF) Q2 2024 Earnings Call Transcript**

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**Body**

Nel ASA (NLLSF)

Q2 2024 Earnings Conference Call

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Company Participants

Hakon Volldal - CEO

Wilhelm Flinder - Head of IR

Kjell Bjornsen - CFO

Conference Call Participants

Erwan Kerouredan - RBC

Skye Landon - Redburn

Christopher Leonard - UBS

Arthur Sitbon - Morgan Stanley

Alexander Jones - Bank of America

Yoann Charenton - Bernstein

James Carmichael - Berenberg

Presentation

Hakon Volldal

Good morning, and welcome to Nel's Second Quarter 2024 Results Presentation. Today, 17th of July 2024. My name is Hakon Volldal, I am the CEO. With me today, I have Kjell Christian Bjornsen, our CFO; and Wilhelm Flinder, our Head of Investor Relations. We have the following agenda: Nel in brief; highlights from the second quarter; strategic and commercial update; production update; technology update; and as usual, we round it off with a Q&A.

After the spin-off of Cavendish Hydrogen, the former Fueling division of Nel, we are now a fully dedicated electrolyzer technology company. We have a century of electrolyzer innovation behind us, and we are pushing for new technologies. We have one single focus and that is to deliver the most energy-efficient and reliable electrolyzers in the world. And we do that together with world-class partners in order to deliver the best-in-class turnkey systems.

Nel is listed on the Oslo Stock Exchange, as you might know, and we have been listed there since 2014. We are a leading pure-play electrolyzer manufacturer. We have installed more than 3,500 units in more than 80 countries since 1927. Manufacturing facilities in Norway and the U.S., Connecticut, more specifically. We are investing heavily in R&D to develop next-generation pressurized alkaline and PEM technologies. We have a global sales network and offices. We are now 430-ish employees. Nel is the preferred partner with industry leaders in different sectors, and we have a cash balance of NOK2.2 billion, which makes Nel a well-funded hydrogen company.

Now, on to the second quarter highlights. Revenues came in at NOK332 million. EBITDA ended at minus NOK79 million. We had an order intake in the quarter of NOK270 million and ended the second quarter with an order backlog of NOK2,071 million. At the end of the quarter, the cash balance was NOK2,228 million. The key developments in the quarter were the following: Nel received $41 million in additional tax credits for manufacturing expansion in Michigan; capacity reservation from Hy Stor Energy for more than 1 gigawatts of alkaline electrolyzers; Nel entered into a technology licensing agreement with Reliance Industries, India's largest privately held company; and the Fueling division was spun out and separately listed on the Oslo Stock Exchange as Cavendish Hydrogen. Subsequent to the end of the quarter, we received a follow-on contract for more than EUR7 million for electrolyzer equipment.

Some more details on the group financials. Revenues in the quarter down 10%, and we are now only talking about the electrolyzer operation. These -- all these figures are excluding Fueling figures. They are reported as non-continued business. This is only ongoing operations. Revenues in the quarter down 10%, revenues so far this year, down NOK27 million or roughly 4%. EBITDA in line with last quarter when we adjust for one-off expenses related to the listing of Cavendish Hydrogen and also some legal cost and expenses related to major agreements that we made in the quarter.

If you look at the year-to-date figures, however, EBITDA is up from minus NOK133 million at the end of June 2023 to minus NOK48 million at the end of the second quarter this year. That also means the EBITDA margin has improved from minus 20% to minus 7%. EBIT has also improved as a consequence of better EBITDA. It was flattish compared to the second quarter last year. Again, if we adjust for the one-off items. And year-to-date, we are down -- we are up from minus NOK217 million to minus NOK138 million. Pretax income and net income improved in the quarter, primarily due to last year being impacted negatively by a valuation of shares in Everfuel.

If you look at the cash balance, you can see that it's down from NOK4.1 billion last year to NOK2.2 billion now. And the major reason for that is that, we spent NOK650 million on propping up Cavendish Hydrogen prior to listing that on the Oslo Stock Exchange. But we are well capitalized now that also the burn rate will come down as Fueling has been spun off. And we don't see a need to raise additional equity to finance our growth in the coming quarters. Utilization of the production capacity will, of course, be adjusted to market demand, and we've taken big investments so far to build out Heroya in Norway for alkaline electrolyzers and also now Wallingford in the U.S. for PEM electrolyzers. And a lot of those investments are now behind us.

If we go into the details on alkaline electrolyzers. We can see that the top line is flattish. It's compared to the previous quarters. It's down 13% year-on-year, flat versus the first quarter. Steady EBITDA development over the past quarters, except for the first quarter, where we had a one-off positive effects from renegotiation of past agreements. And what we can see here is that, the alkaline division with the current volumes that we are producing is close to breakeven, and there's room to do more. So with completion of the second line at Heroya, we can grow our order intake and revenues, we have the capacity to take on more business and also then to grow revenues. And with increased revenues, we will also improve profitability. So the business model for the alkaline electrolyzer division is, I think, proven. This is something we can build on.

On the PEM side, we had a 4% decrease in revenue compared to the second quarter last year. It's up more than 50% from a weak first quarter this year. EBITDA again is flat -- has been flat in the past three quarters and also compared to second quarter the last year. What's important to notice here is that, while we have a gigawatt of production capacity for the alkaline division, we have so far only had roughly 50 to 100 megawatts available in Wallingford for production of PEM stacks. We are now increasing that to 500 megawatts, and that will enable Nel to take bigger orders and also be perceived as a good candidate for customers that want to award larger projects and opportunities to electrolyzer OEMs. This expansion means that it will allow Nel to grow both order intake and revenues going forward. And this is what is needed in order to turn the negative EBITDA figures into positive EBITDA figures.

This is a summary of our order intake and backlog. Order intake in the quarter came in at NOK270 million, up versus second quarter last year, primarily due to order intake in the alkaline division and down from the first quarter this year. Order backlog also fairly flat development over the past couple of quarters with NOK2.1 billion at the end of the second quarter. And as we have previously said, the order backlog is subject to risks such as delays and/or cancellations, but we are also trying to be conservative when we put something into our order backlog. And you can see that most of the order backlog pertains to our alkaline operations accounting for more than 80% of the backlog.

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Strategic and commercial updates in the quarter. We start with this. Cavendish was successfully spun out in June, and that made Nel a fully dedicated electrolyzer company yet again. Assure that. It was spun out on the Oslo Stock Exchange on 12th of June, and we are now dedicating all our capacities and energy and resources and hydrogen know-how to develop the world's most reliable and energy-efficient electrolyzers. And I should add, following the spin-off, Nel takes a significant step towards profitability, and we will also reduce our cash burn.

Here, you can see an example of that. If you look at the EBITDA for Nel ASA what we have reported during the past four years, you can see that the greenish bars represent electrolyzer plus Fueling, whereas the purple bars now represent only the electrolyzer activities. And what now remains in Nel ASA are the purple bars. In 2023, the EBITDA would have been roughly NOK250 million negative EBITDA as opposed to almost NOK500 million negative EBITDA. So far in '24, EBITDA for the Fueling plus electrolyzer division would be minus NOK150 million. We are at minus NOK50 million. So this makes it easier to see that we can actually move towards zero and, of course, positive figures over time. The challenge is slightly less, I would say, than with the combined entity. So that's a positive thing.

Another positive thing and maybe the most positive thing in the quarter, which I'm really proud about is the technology licensing agreement with India's largest privately held company, Reliance Industries. Reliance is renowned for its ability to execute large-scale industrial strategies and is now building a multi-gigawatt fully integrated end-to-end new energy value chain consisting of production facilities for solar panels, batteries, electrolyzers, you name it. And this is, of course, on top of what they are already doing, including operating the world's largest refinery in Jamnagar, India, and having a large mobile operation and digital and retail business in India.

With this licensing agreement, we give Reliance the opportunity to produce Nel's alkaline electrolyzers for captive use globally. So all their -- they can produce electrolyzers for all internal purposes for all their projects around the world and also for non-captive use in India only. They can sell electrolyzers to other companies in India. For that, Nel will receive a compensation. We will also collaborate on R&D, value engineering, standardization and modularization to improve the competitiveness of the electrolyzer platform. This means that this agreement generates an attractive new revenue stream for Nel from a market that would be very difficult for us to access without a partner.

And on top of that, we team up with a highly capable and competent partner to develop our alkaline electrolyzer offering to become even more competitive. And that is something that will benefit all of Nel's customers globally. A significant achievements I'm -- I would say, and also quite, I think, amazing that, out of all the electrolyzer OEMs worldwide, Reliance chose to work with Nel. That makes us feel proud. And I think that's testimony to the fact that we are doing something right in Nel.

Another major achievement is the capacity reservation agreement for more than 1 gigawatt of alkaline electrolyzers from Hy Stor Energy. Hy Stor Energy is a project developer. They are developing the Mississippi Clean Hydrogen Hub, which aims to become the largest zero-carbon, off-grid hydrogen production and salt cavern storage hub in the U.S. The MCHH project will supply renewable hydrogen to support the production of, among other things, green steel in North America. Nel and Hy Stor signed a FEED contract in -- back in December 2023, and we are now the exclusive electrolyzer partner for Phase 1 of this massive project and will provide alkaline and PEM technologies at scale for more than 1 gigawatt. If the project moves forward, Nel will provide the electrolyzer equipment.

So three major commercial achievements in the quarter. We have also a couple of production updates when it comes to our manufacturing capacity around the world. This is a picture of a beautiful line two at Heroya. We have now established an annual production of more than 1 gigawatt. The second line was completed in June. And we now have, as I said, 1 gigawatt of real, fully automated, production capacity for our atmospheric alkaline electrolyzers at our disposal.

And again, having 1 gigawatt is important because customers need to know that we are capable of producing and delivering high volumes without spending years doing it. 500 megawatt is nice, 1 gigawatt is much better in terms of giving customers confidence that we would be a strategic partner for large-scale projects going forward. There are no further major CapEx commitments at Heroya. We will expand production capacity in line with demand. As you know, demand is not there to support more than 1 gigawatts at the moment. And that gigawatt will also be utilized by Nel in line with our order intake or demand. We will not have an organization to support the gigawatt if there's not demand for it.

At the same time, we have the opportunity to expand Heroya to 2 gigawatt if there is sufficient market demand. So we're happy for now. It's fully built out to match demand that we see in -- at the moment based on the pipeline that we have. And if there's a need to go to 2 gigawatts, we can do that quite quickly. Again, because Line 1 was a pioneering initiative. Line 2 is more of a copy paste. And Line 3 would be, again, a copy paste. We have a very short implementation time for new lines at Heroya. And we have a very skilled organization now able to operate these production lines almost flawlessly around the clock, seven days a week, which means we are confident that we can ramp up very quickly if needed.

This is a picture from Wallingford where we produce our PEM electrolyzers. And the goal here is to increase capacity from 50 to 100 megawatts annually to 500 megawatts annually. This is progressing according to plan. All major production steps will be optimized and automated and some previously outsourced processes will also be insourced. Remaining committed investment CapEx through completion for this expansion is roughly NOK120 million. We've taken the lion's share of this investment already.

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There is roughly $10 million, $11 million left of equipment to purchase to complete this. And we aim to have this up and running at full speed towards the end of the year. This will not only improve our capacity. It will also improve the quality of what we produce and it will also significantly reduce the cost of our PEM stacks because it's not only about automation, it's also about enabling new technologies to use of new materials to optimize the cell or stack design in order to get the cost down and the efficiency up.

In the quarter, we also secured an additional $41 million in support for the planned electrolyzer facility in Michigan, and that brings the total support program for a potential Michigan plant to $170 million. Roughly half of that amount is cash incentives. The Michigan plant, we have planned to be around 4 gigawatts, and we are looking to manufacture our next-generation products in that facility. But, again, final investment decision is not yet taken and will only be taken if we see that demand is there to support it. Heroya are up and running at 1 gigawatt, Wallingford on its way to 500 megawatts and a significant support package to support potential expansion in Michigan, if needed.

Now, on to technology updates. And this is what maybe excites me the most about what is happening in Nel at the moment because we are really onto something exciting when it comes to technologies development for the coming decades. When we talk about technology developments, I wanted to show you this because it's not only a Nel's R&D engineers that are driving innovation in Nel.

Yes, we have a big team of R&D people with proven track records and the long experience in the industry, but we're also developing groundbreaking technology together with many, many, many world-class partners around the world. And you see some examples here. This is a selection of our partners in Europe, in the U.S., in Asia, from research institutions to universities, to commercial companies that you might not have heard about to large household names like Reliance, GM, etc. So quite an impressive list, I will say, of R&D partners.

And we tend to tap into this partner network and use our own engineers to deliver on this plan. We believe that we are on the first S-Curve for alkaline and PEM stacks. The alkaline offering is a bit more mature than the PEM offering. But even though it's mature, it's possible to squeeze more out of this technology. We can get the cost down still. We are everyday reducing the cost of our alkaline technology and our PEM technology. We can get the efficiency up.

We can spend fewer kilowatt hours per kilo of hydrogen produced. It's still possible. So we are driving this every single day to make our existing portfolio better. And as we now outsource or license the production of, for example, the atmospheric alkaline technology to Reliance, it's possible to tap into a completely different sourcing supply chain and also continued electrode advancements will improve the efficiencies. So the S-Curve can actually be shifted out to the right through this low-cost country sourcing setup and partnership with Reliance.

However, we believe that in order to fundamentally shift the performance over time, we need to get on to the next S-Curve. And we plan to do that with our next-generation PEM technology developed in collaboration with General Motors based on their long experience with fuel cell technology and our pressurized alkaline stacks, which we are developing internally.

And as these technologies mature towards 2030 and into the next decade, there might be other future technology solutions that could disrupt the technology platforms that we see today. And these enabling technologies could be AEM or solid oxides or other technologies. So we keep an eye on these technologies. AEM is something we have looked into for more than a decade. It's closely related to development of PEM stacks. So Nel is not only developing better existing products, we are pushing the envelope when it comes to next-generation technologies and future generation technologies.

Then how you package this is important. When you look at the existing products that we have, the alkaline stack and the PEM stack, yes, we work to get the cost of those stacks down and the performance up. But it's also about the complete solution that we deliver to a customer. And we are now developing 100 megawatts turnkey modules in partnership with leading world-class EPC companies around the world. We have signed, in the quarter, multiple strategic partnership agreements with world-class EPC partners, which cover different geographies for developing 100 megawatt alkaline and PEM turnkey solutions.

By doing that, we reduce both the price and footprint of large-scale electrolyzer plants, and we allow Nel to focus its R&D on stack and balance of stack. We can focus our energy and resources on what we do best, and we can tap into the know-how and knowledge of the EPC companies when it comes to balance of plant solutions. More details on different collaborations will be announced shortly. You can see an example of our 100 megawatt PEM building block to the right.

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The first part is the power supply to site. This can be consolidated in different ways, and it's really not part of the balance of plant or Nel scope. But if you exclude the power supply setup on the left, then you see the power electronics, the transformer rectifier feeding the electrolyzer stacks, pipe racks, storage tanks, cooling, et cetera. The footprint for this is significantly down compared to existing solutions and it's done in a cost-effective and smart way to reduce the number of components to reduce the layout and to ensure that you have safe, reliable operation of something which delivers 100 megawatt.

This is another example of what we're doing. This is our concept for pressurized alkaline technology. And following a successful stack test of full-sized pressurized electrodes in the first half of '24 turnkey pressurized alkaline prototype will now be built at Heroya in the second half of '24. This is a skid-based solution, where the power electronics, the stacks and the gas separation is all inside 20-foot containers, reducing the time spent on site, the engineering hours, the complexity for the customer and gets the cost significantly down compared to existing technologies.

So this is a very smart way of delivering a complete solution to a customer that Nel is exploring. The footprint is maybe 20% of our existing alkaline atmospheric solution. And it's meant to take Nel into the next era of competitive electrolyzer technologies. So this is a very exciting project where we are delivering on the design criteria for the stacks and now on to building a prototype to verify that the complete design actually works. And it's attracting a lot of interest from partners and potential customers that we have shared this concept with already.

That concludes the quarterly presentation for the second quarter. And to sum it up, we completed our -- the spin-off and separate listing of the Fueling division, creating a fully dedicated electrolyzer company that is now Nel ASA. We signed a licensing agreement with Reliance for production and collaboration of technology development. We completed construction on line 2 at Heroya, bringing annual alkaline production capacity to 1 gigawatt, and we are on track with the PEM expansion in Wallingford. Significantly improved year-to-date financials and shorter royalty profitability and a lower cash burn rate following the spin-off of Fueling and with NOK2.2 billion in cash reserves and a lot of big investments behind us, there's no near-term need to raise additional cash.

With that, I invite our CFO, Kjell Christian Bjornsen on stage together with me to answer questions from the audience, and you -- Wilhelm will do the normal introduction, I guess.

Question-and-Answer Session

A - Wilhelm Flinder

Thank you, Hakon. I see we have some questions coming in already. [Operator Instructions] If we have time, we will also take written questions submitted through the Q&A function. If there are questions we don't have time to answer, please reach out to us on ir@nelhydrogen.com.

And as a reminder from previous quarterly presentations, we will not comment on outlook-specific targets, detailed terms and conditions on contracts, as well as questions on specific markets. Modeling questions, we would also appreciate is taken off-line. So we'll start with a question from Erwan Kerouredan. We have activated the microphone on our end. Please go ahead.

Erwan Kerouredan

[Multiple Speakers] Can you hear me?

Hakon Volldal

Yes.

Erwan Kerouredan

Well, thanks for taking my question. So I have a first question on Heroya the line number two. Can you clarify what it means that you're thinking of adjusting the cost structure and utilization rates? And have you view -- obviously, we will know how the market has been evolving. But, yes, can you give more granularity in terms of utilization rates for the next, I would say, one or two quarters?

Kjell Bjornsen

Well, we will -- we have a backlog, and we do not intend to build a large store of readily produced electrodes. And with the backlog we have, there's no need for running the two lines we have at Heroya full speed. So we will be running at less than full speed for the next couple of quarters. And then we will be tuning up and down based on whatever order intake we have.

Erwan Kerouredan

Understood. Thanks. And then on the cost structure side of things, what does it mean in terms of your progress towards EBITDA breakeven? Is it like a slower pace versus anticipated or something else? Thank you.

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Kjell Bjornsen

So the most important thing for us to reach EBITDA breakeven is that, the volume we produce and deliver in any given quarter. So, of course, the quicker we get the order intake in, the quicker we'll get to positive EBITDA.

Erwan Kerouredan

Okay. Thank you. And last question, please, on technology strategy. If I'm not mistaken, it's always been known that you were looking at AEM further out. But it looks like solid oxide is a bit of a new thing. Can you clarify -- can you confirm that? And then give some color as to what prompted you to look into that technology?

Hakon Volldal

We can't explore all available technologies out there. And we know there is a market for PEM and alkaline electrolyzers. We are uncertain what the market will be for solid oxide and AEM. Both technologies look very promising when you look at the theoretical KPIs of these two platforms compared to PEM and current alkaline technologies. But the bar is constantly being raised because the existing technologies get better. And we think we need more calendar time both for solid oxide and AEM to get to a competitive CapEx level.

You should also know that solid oxide is a high temperature technology, meaning it operates at around 600 to 1,000 degrees Celsius and only a few processes lend themselves to that technology. You need to have excess heat or waste heat in order to run the solid oxide electrolyzer in an efficient way. If you do have that, then you have very interesting efficiency numbers for that technology. AEM is kind of like a hybrid or PEM and alkaline, where you take the best of both platforms. You get the footprint -- the small footprint of the PEM stack and the differential pressure.

But it operates in an alkaline environment, meaning you don't need iridium and other expensive platinum group metals. You get the cost benefit of the alkaline platform and the efficiency benefits of the alkaline platform combined with the footprint and pressure benefits of the PEM technology. But, I would say, I don't think my perspective is, I should say, that solid oxide and AEM are not technologies that will become extremely relevant in this decade. We'll be looking at the next decade before these technologies will start to get big orders and then only for certain applications initially.

Erwan Kerouredan

Understood. Thank you. It's very helpful.

Wilhelm Flinder

Thank you. Next question comes from Skye Landon. Please go ahead.

Skye Landon

Thanks for the presentation. On the Reliance deal, can -- my question, what your current expectations are when Nel would start receiving royalties from Reliance and what the materiality of these could be? Can you share anything about Reliance's planned capacity size? And also, do you know if Reliance is looking at any other technologies alongside alkaline? Thank you.

Hakon Volldal

So we cannot disclose too much information about the agreement with Reliance. But we have already booked revenues from this agreement as order intake in the second quarter, and we have already received payments. There is an upfront portion and there's a running portion. And, of course, the running portion depends on how fast they roll out the technology and how much they produce. Their immediate plan, as they have said officially is to get 2 gigawatt scale next year. That's what they have said. And again, in India, things can take more time, but things can also move extremely fast. If we are able to transfer our know-how and knowledge to them quickly, and then we're working on that every single day now.

Our expectation is that, we will get 2 gigawatt scale next year. And that -- following that, they will -- if they like what they see, they will quickly expand that beyond the first gigawatt to something bigger. But I think it's wrong of us to comment on Reliance plans. So we should be careful to put words in their mouth, but it's a sizable revenue and profit opportunity for Nel. How big it becomes, depends on how much they actually do. But knowing Reliance, they're not into this because they think it's interesting to be at low digit gigawatt scale, they want this to be significant, and they want it to be big. Otherwise, it's not worth their time and attention.

Skye Landon

Understood. Thank you. And on the technologies, are they looking at anything other than alkaline?

Hakon Volldal

Right now, the focus is on alkaline technology, our platform, which lends itself nicely to a low-cost setup in India. The plan is to make sure we can produce at scale Nel's existing atmospheric alkaline stacks and then get the cost down on that and together with them also improve the efficiency through new material selection and further enhancements of membrane technology and coatings, et cetera. So it's -- this is their primary focus at the moment. I'm not aware of other electrolyzer initiatives for the moment.

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Skye Landon

Thanks. Great. Thank you very much.

Wilhelm Flinder

Thank you. Next question comes from Chris Leonard. Please go ahead.

Christopher Leonard

Yeah, guys. Sorry. Hopefully. Now I'm unmuted. Could you please just provide an update on the 200 megawatt U.S. contract? I believe it's been over a year now since you've recognized the revenue and haven't yet received the cash. It accounted for like 34% of 2023 electrolyzer revenue. So when do you think you'll need to take the decision to write down that contract? Can you give us some visibility on that? And secondly, does that also link to why you're maybe looking to reduce Heroya utilization rates going into Q3, Q4 due to the risk of remarketing that 200 megawatts of production? Thanks.

Kjell Bjornsen

So on that, it's an ongoing evaluation when you have an outstanding receivable of that size. And we would have taken decisions on that already if we didn't see progress on the project and progress on the funding. And also keep in mind that we have received a sizable amount of money already. So there's definitely some lock in from the project owner side to make this happen. We will continue to work closely with that one customer. We still continue to believe that, that project will be realized, and we will monitor the situation closely. If it turns out that the project is no longer going forward, we will, of course, have to remarket 200 megawatt. That is not in current plans on the utilization of Heroya.

Hakon Volldal

We might add that we have recognized revenues from the project, but the EBITDA part that we have recognized has already been collected in cash. So if the project will have to be written off, it wouldn't impact the EBITDA, it would impact the top line only. So that's one thing. The other thing is, you might be aware that it has been a challenging regulatory environment, both in North America and in Europe, and it continues to be that way, but with signs of improvement. In Europe, they have now on a national level, approved some of the IPCEI funding that was awarded probably a year ago, which means that projects winners can actually receive money from national governments to support the IPCEI projects.

In the U.S., however, we are still waiting for clarifications around the detailed regulations of IRA. And what does it take to qualify for the $3 production tax credit? This is impacting U.S. projects negatively, including the project we are talking about here. We need visibility and clarity on this. Treasury has come out with an initial recommendation. There were thousands and thousands of comments to this proposal. And our understanding is that, they're working through all these comments and have the ambition to come out with a final regulation this year. But this project that we are talking about here is, unfortunately, a bit of -- is negatively impacted by the lack of clarity. And there are other projects as well, both Nel projects and non-Nel projects that are in the same situation.

Christopher Leonard

Thanks. And just on the customer. I mean, is it fair to assume that your view of an ongoing decision will be taken? Is it fair to assume that they've actually got capital that's been raised and that their liquidity is in a good enough spot for you to think there's not risk here?

Kjell Bjornsen

Well, if there have been zero risk, we would have taken a higher share of the RAN (ph) or EBIT impact. So this has been highlighted as a risk. We think the financial disclosure around it is balanced. And the way it has been presented now and again, keeping in mind that we have only taken the result impact equal to the cash received. So you could say from a worst case perspective, we get a receivable is suddenly an inventory at cost to produce rather than being a receivable.

Christopher Leonard

Thank you. Thanks, guys.

Wilhelm Flinder

Thank you. Next question comes from Arthur Sitbon. Please go ahead.

Arthur Sitbon

Hello. Thank you for taking my question. It's basically about the recent European auction results where the price premium that was granted to the bidders was around EUR0.40, EUR0.50 per kilo of hydrogen. Does that mean -- because it looks quite low. Does that mean that for projects to work economically, it's all about offtakers paying a premium for green hydrogen over gray hydrogen? And if so, do you see willingness to do that from the offtakers? And what is driving this willingness to pay if there is any willingness to pay for a premium?

Hakon Volldal

Yeah. I think the cost gap between gray hydrogen and green hydrogen is definitely higher than EUR0.50 per kilo. It's much higher at the moment, unfortunately, which means that the auction -- I view the auction as more opportunistic. There are some companies that might be fully financed. There are projects that might have offtakers that are willing to pay a significant premium over gray hydrogen, and this is just icing on the cake because EUR0.50, EUR0.40 is definitely not enough to close the gap towards gray hydrogen. So have that in the back of your mind. The cost gap is bigger.

But yes, there are offtakers that are willing to pay a premium that is quite significant because they want to decarbonize their operations, and they have very few alternatives to hydrogen. I think that is the primary motivation at the moment. As long as we're not talking about gigantic gigawatt projects, but we're talking about projects in the hundreds of megawatts, the offtakers are not buying massive quantities, right? So they could be willing to pay a premium for a small portion of everything that they buy.

And this is important because this is what we need to get off the ground. Over time, we know we will reduce the gap towards gray hydrogen, but we need somebody who is willing on the offtake side to pay the current premium in order to jump-start this industry. And we do see that funding helps, it closes the gap, but EUR0.50 is not enough.

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Arthur Sitbon

Thank you very much.

Wilhelm Flinder

Thank you. Next question comes from Alex Jones. Please go ahead.

Alexander Jones

Thanks very much. You showed a chart showing alkaline EBITDA over time has been relatively flat ex the one-offs last quarter. Can you talk a little bit about what's going on beneath the service? Because I think if we go back to last year, you talked about sort of mix improvements leading to improving margins. And clearly, that's not visible in the headline results. So has that happened and just been offset by scale up costs or is a lot of that mix improvement still to come?

Hakon Volldal

Yes. That mix improvement is yet to come. And there is no top line growth which we also need to benefit from the scale advantages that are inherent in this business. What we report on are still a lot of the projects that we signed with full scope. They do not reflect fully the stack balance of stack scope that we now have. As you know, some of these projects have been delayed and postponed. So I think the full visibility on the intrinsic margins, our stack balance of stack offering is not yet visible fully in the P&L.

Alexander Jones

Okay. And just to follow up on that, should we expect any improvement in the second half or are we really looking to next year and afterwards to see that mix come through?

Hakon Volldal

Second half will probably be fairly similar to first half. And we aim to close out a lot of the full scope projects during the year. And then it depends on the order backlog for '25. If we get sufficient volume for '25, we should see a margin improvement. If we don't get order intake, then, of course, the margin improvement will be eaten up by low utilization and overhead. But same top line. So if you assume the same top line next year with the stack balance of stack mix, the margin should go up. But then we need to deliver on that same volume.

Alexander Jones

Thank you.

Wilhelm Flinder

Thank you. Next question comes from Yoann Charenton. Please go ahead.

Yoann Charenton

Good morning, everyone. Thank you for taking my questions. So I would like to come back on to the point you just made about the second half of the year that will look very similar to the first half in terms of margin. I'm just trying to understand what we have seen so far in the first half in terms of top line level. It looks like you are running below the run rate that is implied by what again was reported in your annual report in terms of revenue recognition expected this year for the electrolyzers segment at the time. So I'm just trying to understand why margin is not going to trend higher in the second half, assuming the top line is set to recover from here. So that would be the first question.

And then the second question is maybe a bit more broad-based. Coming back on to some points you commented on as well during this call. It's about these auctions. We know that now and some OEM peers have been negotiating with EU authorities for the inclusion of Made in Europe restriction for equipment that is basically ordered by participant into these auctions. Any update on this issue you may provide?

Hakon Volldal

I can start with the second part, and then you have time to let the first part mature, Kjell Christian. We are in -- we're not negotiating with the EU Commission, but we try to offer our opinions to the EU Commission on how they can design the second upcoming hydrogen bank auction in order to get the outcome that the EU actually would like to see because even though participation in the first auction was very good, more than 130 projects, I think, applied for funding. Only a handful of projects were awarded money and out of those projects. It looks like a significant portion of equipment will be sourced from China.

What we are asking for is a level playing field. We want to compete on equal terms with the Chinese. And it's not fair that we are at a disadvantage in Europe when it comes to competing on these deliveries. And that's all we're asking for. We have -- I don't want to go into details on what we have proposed that you can find in some of the press releases we have sent out.

But I think the European Union definitely is aware that they need to do something in order to have a higher value creation in Europe for European tax money -- taxpayer money spent on subsidizing hydrogen. But, again, the EU wants to be best-in-class when it comes to following WTO rules and regulations. China doesn't do it. U.S. doesn't do it, but Europe wants to do it. So it's hard to design criteria that will lead to a Made in Europe outcome.

But I think it's needed if we want to see a successful European OEMs with deliveries in Europe and not everything being imported based on subsidies and other mechanisms. So I think there is absolutely an interest inside the EU to move closer to, let's say, Made in Europe approach. Exactly what the rules and regulations they will come up with for the second auction have not yet been decided. That will be decided in the next coming weeks.

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Kjell Bjornsen

And then back to the margin part of the question. The comment was in percentage terms. We will continue to be impacted by some of these full scope projects that are still not closed out. We have managed to close out some of the old ones, and we are continuing to work on closing that out. And as you know, if you have a project going over time, then often that goes over budget as well. And when that comes at the end of the project, there's really not much new revenue to match that with. So while we do get some cost coverage, there's not great margin, if any at all, on the projects that are over time.

If you look at the backlog reported in the annual report, the backlog continues to be under pressure for cancellation and delay. So we do see some risk. However, there are also some upside. So I think it's too early to be precise on revenue for this year. The first couple of quarters, we've been a bit slow on deliveries on a few milestones compared to what we would have wanted. So on our major project for delivery this year, there's still significant deliveries to be done for the year.

Hakon Volldal

At attractive margins.

Kjell Bjornsen

At attractive margins.

Yoann Charenton

Thank you. That's very clear.

Wilhelm Flinder

Thank you. We have another question coming in from Arthur Sitbon. Please go ahead.

Arthur Sitbon

Thank you. Thank you for taking my question. With all the agreements that have been concluded, the capacity reservation, order agreements as well, I was wondering if you could help us understand a bit how much of your manufacturing capacity is reserved or already committed for 2025 to 2027. Thank you very much.

Hakon Volldal

If the capacity reservation agreements are actually executed, we will need the capacity we have now established at Heroya into '25 and '26 and first part of '27. If they are not executed, we have a lot of available capacity. If we get additional orders on top of the reservation agreements and the reservation agreements are executed, we would probably need to add capacity. So the outcome is, I would say, still a bit uncertain. We don't have a lot of visibility on this. Best case is that, we are fully booked almost. Worst case is that, we have a significant job to do to fill the factories in '25, '26 and '27.

Arthur Sitbon

So to be clear, does that mean that until you have visibility on this large capacity reservation agreement, you can't really be sure of how you're going to address new orders because how would that work [indiscernible]?

Hakon Volldal

So we will take new orders. If we take all new orders, and if some of these larger capacity reservation agreements are then executed, these are multiyear deliveries, which means we have time to increase capacity. We can even source from Reliance in India if we need. So, I'm not worried about the ability to deliver, but it's a bit hard to give you precise figures on the utilization rate for Heroya in '25, '26, '27 at the moment, given that we don't know when these capacity -- if and when these capacity reservation agreements will actually be confirmed.

Arthur Sitbon

But does that mean in other words, that any new large order would trigger a further expansion of Heroya?

Hakon Volldal

No. It means that we will -- a confirmed order we will always take, given that the conditions are attractive. And then if a capacity reservation agreement is then later executed and we need additional capacity because we have already filled up the factory, then we have time to add more capacity, if needed, but we're not at that point yet.

Arthur Sitbon

Okay. Thank you very much.

Wilhelm Flinder

Thank you. Next question comes from Skye Landon. Please go ahead.

Skye Landon

Hi. Thanks for taking my second question. On the 1 gigawatt capacity reservation with Hy Stor, can you run through the steps that are needed for this project to take FID and become a firm order? And then more generally, when are yourselves at Nel expecting to start seeing firm orders and project FIDs to start sort of flowing back into the market? Thank you.

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Hakon Volldal

The larger projects, we expect FID towards the end of '24 early part of '25, specifically for Hy Stor. This is about the green steel project, where the customer is -- the offtaker is currently in discussions with the Department of Energy for subsidies on part of the capital expenditure because we're talking lots and lots of billions of dollars for this project. It's not fully -- it's not dependent on getting support from DOE, but it would help.

So what we do need is for the offtaker to commit to a green steel project in the U.S. If they do that, then Hy Stor is the exclusive partner for delivering green hydrogen, therefore, the production of the DRI steel to that offtaker, and we are the exclusive provider of electrolyzers to Hy Stor. So I think it all comes down to whether the offtaker in this case, the steel company will move forward with the DRI facility in North America.

Skye Landon

Understood. Thank you.

Wilhelm Flinder

Thank you. We have two more questions, and then we are ending this Q&A session. Chris Leonard. Please go ahead.

Christopher Leonard

Thanks for taking my follow up, guys. You got -- looking at 2025, obviously, you said that some large orders could come in at the back end of this year and maybe into the start of '25. Given your electrolyzer backlog, first half is around down 16% year-over-year. How comfortable are you with consensus revenue expectations to show 25% revenue growth in 2025? Do you really need to see orders come through instantaneously in the next quarter to be able to reach those levels? Thanks.

Hakon Volldal

We are quite confident that we will sign orders in the third quarter and fourth quarter. What we are not confident about yet is how much are we talking about? We have a significant pipeline with the median project size is in the hundreds of megawatts. We don't need a lot of them, but we do need a couple. Without any new projects, '25 is going to be challenging, and there will be no top line revenue growth.

With a couple of these projects, we have the opportunity to have a very good '25. So I think, unfortunately, the visibility is a bit low at the moment. When we look at the project pipeline, ongoing discussions, LOIs, contract negotiations, there's a lot of activity. And at least, I should speak for myself, I am confident that we will sign contracts in the third and fourth quarter that are meaningful to Nel, meaning not Mickey Mouse contracts, but sizable contracts with meaningful production volumes.

Christopher Leonard

Great. Thank you.

Wilhelm Flinder

So we will take one last question from James Carmichael. Please go ahead.

James Carmichael

Good morning, guys. Sorry, I think I muted myself. Just quickly, I mean, you sort of touched on it earlier, but it feels like quite a lot of the outlook is dependent on the U.S. and the time line on that 45B tax credit has been moving quite a lot as expected end of last year, then I think broadly speaking, there was an expectation in June or July this year. And now it feels like it's slipping to the right again. I appreciate that you can't control it.

But what's the sort of the major holdup? There are headlines around this sort of Chevron deference ruling from the Supreme Court. The three pillars are obviously causing some problems. What was your sort of best estimate and best understanding of how quickly that can all be resolved? And, I guess, any sense you've got of what the Trump administration, if it comes in, might due to that if it's not passed in time limit?

Hakon Volldal

If I left you with the impression that the pipeline that we're looking at in terms of prospective new projects are mostly in the U.S., then I have misled you, because it's -- that's not the fact. If we look at the pipeline, we do have projects in the U.S. We do have projects in Europe, and we now actually see significant projects in Asia. Asia is moving at its own pace, I would say. They were far behind. Now they're catching up. And the key driver is not so much decarbonization, but energy security, energy import, they need more energy.

And it's hard to build new nuclear energy facilities. It's hard to build solar. It's hard to build offshore, onshore wind in some of these countries. If you look at Japan, South Korea, et cetera, they need to import energy, and that energy has to come from other countries where it's possible to build out renewable energy. And then hydrogen is the energy vector, the sort of the molecules you transport in order to get the energy back to the homeland. So we have a couple of very promising projects in Asia, and we expect activity there to pick up.

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In Europe, activity has been held back by high interest rates and difficult funding environment and lack of support. A lot of ambitions have been announced by politicians, both inside the EU and on local or national level, but very little money has actually ended up in a bank account that can be applied to buy electrolyzers from Nel and other OEMs. That is improving. We see some money now being paid out.

In the U.S., we are waiting for the clarifications from Treasury around production tax credits. And although we don't assume that the Trump administration will be as forward leaning as the Biden administration has been on this. It's going to be very hard to reverse a lot of what has been put in motion. If there will be other things on top, we are probably not expecting that to happen. But again, the Treasury needs to come out. That is what is holding back progress in the U.S. Even if that takes more time, we have good opportunities in Europe and Asia. So our pipeline, I would say, is fairly diversified. We don't depend on one continent only to make progress in order to win new orders.

James Carmichael

Thanks a lot.

Wilhelm Flinder

So yeah, that was the last question, which ends this Q&A session, and please reach out to us on ir@nelhydrogen.com for further questions. And with that, I'll give the word back to management for any final remarks.

Hakon Volldal

Thank you, Wilhelm. First quarter was all about incentives. We got a lot of support, in particular, in North America to fund the R&D programs and also for the potential Michigan expansion. So the headline was subsidies and support. I think the headline for the second quarter is strategic agreements with Reliance, of course, being the key agreement that we signed. We've also landed a capacity reservation agreement with Hy Stor. We have signed strategic partnership agreements with world-class EPC companies. And we've also spun out Cavendish Hydrogen.

So I think the second quarter is really about deal-making. And let's hope the third and fourth quarter will be all about new orders. We remain optimistic and hope to come back to you in, what is it, October, with more visibility and clarity on how we expect the rest of '24 and '25 to unfold. But as I said, we remain positive about the outlook for hydrogen, Nel's position specifically, and hydrogen's position more broadly. And yes, we do everything we can on a daily basis to get more orders, and we remain confident that we will get that. So with that, thank you. Thank you for your time. Thanks for listening in. Have a great summer break, and see you back in October.

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