

# **Siemens Energy AG (SMEGF) Q2 2024 Earnings Call Transcript**

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**Body**

Siemens Energy AG (SMEGF)

Q2 2024 Earnings Conference Call

May 8 2024 4:00 AM ET

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Maria Ferraro - Chief Financial Officer

Michael Hagmann - Head of Investor Relations

Conference Call Participants

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Gael de-Bray - Deutsche Bank

Alexander Virgo - Bank of America

Akash Gupta - JPMorgan Chase & Co.

Phil Buller - Berenberg Bank

Sebastian Growe - BNP Paribas

Ajay Patel - Goldman Sachs

Nick Green - Bernstein

Will Mackie - Kepler Cheuvreux

Max Yates - Morgan Stanley

Sean McLoughlin - HSBC

Presentation

Operator

Ladies and gentlemen, welcome to Siemens Energy's Q2 Fiscal Year 2024 Analysts Call. As a reminder, this call is being recorded.

Before we begin, I would like to draw your attention to the safe harbor statement on Page 2 of the Siemens Energy presentation. This conference call may include forward-looking statements. These statements are based on a company's current expectations and certain assumptions and are, therefore, subject to certain risks and uncertainties.

At this time, I would like to turn a call over to your host today, Mr. Michael Hagmann, Head of Investor Relations. Please go ahead, sir.

Michael Hagmann

Thank you, Nirav. Good morning and a warm welcome to our conference call this morning. As always, our documents were released at 7 o'clock on our website. I am very pleased to have our President and CEO, Christian Bruch; and our CFO, Maria Ferraro with me. Christian and Maria as always will take you through the major developments of the last quarter. Hopefully, this will take roughly around 30 minutes and, thereafter, as always, Christian and Maria are available to answer your questions. For the entire conference call, we have allowed a little bit more than an hour.

And with that, I will hand over to Christian.

Christian Bruch

Thank you very much, Michael, and good morning everybody, also from my side. Thank you very much, like always, for joining us for this conference call today. Let me start with the market. We continue to see strong electricity demand. In fact, I have to say the market has exceeded our expectations. And the good start, what we had into our fiscal year, continued also during the second quarter for the majority of our businesses. These are benefiting really from the energy transition.

Gas Services, Grid Technologies and Transformation of Industries, have turned now into successful businesses and they are all positioned to deliver profitable growth. At Siemens Gamesa, we are working, as before, through the resolution of the quality matters and the offshore ramp-up. We have also used the last couple of months to detail out our way forward. I will provide you with an overview on this a little later.

Across Siemens Energy Group, we did a bit better this quarter than expected on key KPIs. Our order backlog grew to a record level of €119 billion, orders in the quarter declined by 22% as we were up against very high prior year order levels at Siemens Gamesa and Gas Services in particular. This said, orders for the half year are still up by 1%.

Revenue rose 4% in the quarter and 8% in the first half in both cases driven, particular by Grid Technologies, but also Transformation of Industry. Profit before special items rose from €41 million to €170 million in the quarter. This was also higher than expected, but also influenced by positive currency effects. This means, so far this year's profit stands at €378 million compared to a loss of €241 million last year.

Loss at Siemens Gamesa were for the first half somewhat lower than expected and therefore we are well on track to stay within our guidance for Siemens Gamesa for the full fiscal year. We continued to execute our divestment programs. Maria will give an update on this and the solid cash flow development drove our net liquidity higher so that we again have a very solid balance sheet.

Based on the positive development during the first half, we are raising the guidance for the full year on several KPIs. We now expect 10% to 12% revenue growth year-over-year. We lifted the lower end of the guidance for our profit margin before special items by 100 basis points and we also expect much stronger cash flow, which in part reflects the stronger order pipeline as we see it today. As I said before, the market environment remains strong with electricity market growth exceeding our expectations.

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On this slide, it is shown that the midterm expectations for electricity consumption have increased over the last two years under the various scenarios and in order to meet this growing demand, our customers have been placing orders and we expect that they will continue to do so. This means for us that on the one side, Gas Services will continue to be a very strong pillar. Karim and his team have been improving the size and the quality of the order book and it will be a predictable, profitable and cash flow generating business for many years to come.

And the other thing is the stronger than expected order and revenue growth in Grid Technologies means that Grid Technologies is on a trajectory to reach the size and profitability of Gas Services faster than expected. Booking orders of €12 billion during the first half, Grid Technologies is on track to have higher orders than Gas Services for the second year running and the strong orders are now converting into revenue growth and a strong margin improvement.

We already started some time ago to increase our capacities to cope with the growth in Grid Technologies. You may also have seen that we have launched new factory expansions for transformers in the U.S. and in India over the last couple of months.

Moving on to Siemens Gamesa, we are working through the quality matters on onshore and see the level of cost which we -- have been accrued for these quality matters still appropriate. In offshore, our ramp up continues and is progressing as planned in Cuxhaven, Aalborg and Le Havre. I already said in the last quarter that in Hull, we still not have reached the desired output volume. It is improving.

We have been able to accelerate the ramp up of the workforce and we have been able to avoid project delays, but also there still needs work to be done. We are not at the productivity level which we aspire, so this will still need some time. As well, obviously, we will need time to work through the quality matters.

Over the last two years, Jochen brought many measures on the way to drive really the operational turnaround. And we have also now agreed a long-term strategic forward-looking plan to bring finally the business back to the desired double-digit operating margin.

Let me on this way forward share a couple of key points. First of all, an important message is, we will be active in onshore and in offshore. In onshore, we have defined a more focused approach to the market. We will develop new onshore business based on first of all selected regions and second based on revised 4.X and 5.X platforms, but with a heavily reduced number of variants. This is what Jochen and the team has been also driving over the past couple of months to already simplify the product structure in our company.

We mentioned at the Capital Market Day that we will only focus on attractive markets where we have a stable regulatory framework and attractive profit pool and a value-based customer landscape and where there's a match between the market requirements and our offering. Europe offers these characteristics and therefore is a core market and we intend to restart sales activities in Europe with a 4.X towards the end of the fiscal year and for the 5.X platform next year.

We see similar characteristics also in the U.S. and will therefore also remain active in the U.S. based on existing products and intend to launch a revised product at a later stage. We may also serve other market opportunistically, but only if it makes real commercial sense. And for the new business, please keep in mind the volumes will not come back immediately. We still have a big plan to work through and we also have still the quality matters, but we are confident that we are able to rebuild the strong market position over the coming years, but it's really a long-term trajectory.

Our service business in onshore remains an important pillar given that we are servicing one of the largest fleets in the market and we will continue to do so. Based on the focus strategy and the reduced workload in onshore we have because of the interruption of the sales activities, we are adapting our manufacturing footprint and optimize our structures.

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In offshore, as a market leader, we have been building a track record with the SG 14 platform, which will be our volume product at least under the end of the decade. This is something which we see growing. So we're trying to balance obviously the two things. We have for offshore received more orders in gigawatts for the SG 14 platform than for any of the previous platforms.

This year you also might be aware in offshore the auctions account for around 40 gigawatts of capacities, which marks a major restart of the offshore bidding activities for us in the coming years and that obviously we want to capture with our volume product.

We are also progressing now the integration of Siemens Gamesa functions into Siemens Energy.

By 1st of June we will start to integrate major central functions and as I said before, over the last two years Jochen has done a tremendous amount of difficult work and laid the foundation for the operational turnaround and how to integrate the business into Siemens Energy. We are currently initiating now together with many measures which will determine the long term improvement in our wind business.

This is obviously also where Jochen and I discussed how can we ensure a smooth generational change in the leadership at Siemens Gamesa now while we take so many long term decisions. We decided that Jochen hands over the leadership from Siemens Gamesa on August 1st from himself to Vinod Philip, which is I would say probably a bit earlier than we actually wanted to do. But it's really due to the fact that we're saying, hey we are now embarking on all these long term things.

The good thing is Jochen committed also to stay around as long as needed. He is a fantastic turnaround manager and has done a really good job. We are not through with the turnaround also clearing Thales and this is why we have to make this balance wisely at the same time it is something where obviously the long term things we do not want to see.

And this was our agreement, a leadership change in one and a half years from now when we are in the middle of the ramp up. That is a bit the logic case, a question. Vinod Philipp obviously with his background in running the service operations, in being the Strategy Head, in running central functions and being a lead person in the integration of these functions in Siemens Energy is a very capable and helpful manager then to drive the journey from Jochen, forward.

Let me give you some highlights of projects of this quarter. Like always at the CMD we highlighted that roughly 30% of the new gas-fired power plant installation will be driven by the coal to gas shift. Poland today is still generating 60% of its electricity from coal but it is committed to phase out coal by 2049. We just won our third big coal to gas project in Poland. The power plant in Adamow will emit 50% less CO2 than the coal-fired one which it is replacing, positive news on that one.

Last quarter, I also talked about the first installations of our SG 11 turbine in the U.S. This quarter, I am pleased to be able to announce that we have started the installation of the first 60 Siemens Gamesa SG 14 wind turbines at the Moray West offshore wind farm in Scotland with a rating of up to 14.7 megawatts. The total capacity will be close to 900 megawatts, enough power to supply 1.3 million homes in the UK.

The third project is Adriatic Link, one in a row I have to say, which is a bi-directional underwater cable with a total transmission capacity of 1 gigawatt developed by Terna. The project will connect Italy's north and south regions over a distance of 250 kilometers via the sea. This is the Tyrrhenian Link, which we booked last year in quarter two; this is now our second HVDC project in Italy.

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And as you know, we also have set up a partnership with Air Liquide in hydrogen and I have said before, that brings really the best of our perspectives together. The tangible outcome is a 20 megawatt hydrogen electrolyzer which we have installed at the site in Oberhausen in Germany with Air Liquide. And it's a step into the hydrogen business, but obviously there's a long way to go also there to make it really a growing business.

With this, I would hand over to Maria.

Maria Ferraro

Thank you, Christian, and good morning everyone, from my side. So let's perhaps get right into it and go to the overall Siemens Energy Group slide. As Christian just mentioned, the strong development from Q1 continues into the second quarter and we see positive momentum across our businesses.

Looking at orders, orders decreased year-over-year. This was driven as expected from decreases at Siemens Gamesa. This is due to the sharply lower volume of large orders and Gas Services also primarily due to timing shifts and a high basis of comparison. Overall decline was around 21% on a comparable basis. Orders came in at €9.5 billion; book-to-bill still above one at 1.14 and this is driving our order backlog once again to a new high of €119 billion.

Revenue for the group grew by 3.7% on a comparable basis to €8.3 billion. This was driven by growth at Transformation of Industries just over 11% and especially at Grid Technology just shy of 26%. And this offset declines at Gas Services and Siemens Gamesa. Once again, we had a very strong service season in the second quarter and our service revenue grew stronger than the new unit's business which resulted in a favorable business mix in the second quarter.

Profit before special items improved to positive €170 million. This is mainly driven by Grid Technologies due to higher volume and underlying conditions and backlog and Gas Services again due to a very strong service season. In addition, this quarter we benefited from a positive currency effect associated with the devaluation of the Egyptian pound in March of this year.

Just a quick explanation in this regard, on the 6th of March 2024, the Central Bank of Egypt allowed the Egyptian pound to float and subsequently the Egyptian pound depreciated by approximately 60%. Our company in Egypt holds external sales contracts mainly in euro. As there's no liquid forward market in Egyptian pound, the resulting euro risks could not be hedged.

Accordingly, this led to foreign currency gains in the local financial statements which are prepared in Egyptian pound.

These locally recognized foreign currency gains carried through at the SE Group level and therefore we benefited from a foreign currency related gain of approximately €92 million in the second quarter above the profit line. This is just also, a side note, this is the absolutely appropriate treatment. This has no economic benefit and does not qualify for our special items definition as such. Given that mainly Gas Services and Grid Technology are active in Egypt, this is reflected in these two business areas which you'll see later in the presentation.

Looking at special items, this amounted to positive €331 million. This is driven by pre-tax gains from the sale of businesses. This is related to our ongoing progress of our divestment program. As a result, this brings us to profit for Siemens Energy for the quarter of €501 million and a net income of €108 million. Free cash flow pre-tax, this improved strongly to positive €483 million.

This is contributing across all businesses but especially with very good conversion on our Gas Services business as the strongest contributor, also due to the development of operating network and capital. The cash outflow of Siemens Gamesa was a bit lower than expected. This is purely due to timing shifts and we maintain the overall minus €2 billion free cash flow guidance for Siemens Gamesa but we'll talk about that a little later when it comes to the guidance overall.

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Moving on to our order backlog, as I mentioned, the backlog reached another record high of €119 billion at the end of the quarter and of course what's important not only about the growth is the order backlog quality and here we see the positive trends continue. This is supporting and underpins our midterm targets. Close to 50% of the overall backlog is service and this means, as Christian mentioned in the context of GS, predictable, recurring, resilient, high margin and cash generating business for many years to come.

We're also seeing strong backlog growth in our new units business and this is also important as the new units help us to grow the installed base and to build the base for additional service revenue in the future.

Now let's take a look at our liquidity status and the cash bridge for the quarter. But first a quick update on our divestment program, where do we stand? Here we made again very strong progress in the second quarter after closing the sale of the 18% stake in Siemens Limited India to Siemens AG in the first quarter. Just as a gentle reminder, this transaction resulted in a cash inflow of roughly €2.1 billion and a one-time P&L gain of close to €1.7 billion.

In the second quarter, we closed another three transactions. We also mentioned this in the Q1 presentation, the sale of Trench Group to Triton, the sale of our 32% investment in Windar and one other smaller transaction. All of this resulted in cash inflow of close to €700 million and around €350 million in bookings from those disposals.

So therefore, after the first six months, we now stand at more than €2.9 billion cash proceeds from our divestment program with one other smaller transaction still in progress. So as a result, we revised upward our original guidance for divestment proceeds from the €2.5 billion to €3 billion range to around €3 billion.

So now looking at the Group's cash bridge as at the end of Q2, overall, as you see here, we have €5.8 billion in cash and cash equivalents, €4 billion of financial debt, of which €3.3 billion is long-term. This brings us to a net cash position of €9 billion. This is up from the net cash position of €1.4 billion at the end of Q1. This is again in line with our target to maintain a net cash position throughout the year.

The €700 million of net proceeds, which I just mentioned, as well as positive free cash flow, of course, constituted the main cash inflows, whereby we also had outflows related to, of course, tax, treasury shares, financial interest, and some other smaller items. Net cash adjusted for our pension obligation, then amounted to €1.3 billion at the quarter end. This is an improvement of more than €2 billion versus the end of the last financial year.

So just one word on the undrawn credit line, in February, we successfully refinanced the existing revolving credit facilities with a consortium of international banks. This reduced the total volume of the RCF from €5 billion to €4 billion, of course, as a result of the successful financial integration of Siemens Gamesa and following an optimization that we've been working on of our financial structure. The new RCF has a maturity of five years.

So with all of this, we now have a very strong balance sheet as of the second quarter of fiscal year '24, again, in line with our commitment of a conservative financial risk profile, as well as our commitment to an investment-grade rating profile.

Moving now to the businesses, starting with Gas Services. Here a very solid quarter for Gas Services indeed against a very strong prior quarter with a continuation of its strong track record in profitability and cash conversion. In the second quarter in GS, we booked orders of €3.4 billion. This is just shy of 21% below the high base of comparison in prior year.

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From a regional perspective, the main orders come from North America and the Middle East. Book-to-bill was a strong 1.3, and the order backlog rose to €43 billion. In Q2, we booked 15 gas turbines, greater than 10 megawatts, thereof 11 large gas turbines and four industrial gas turbines. The market for gas turbines was strong in Q2, and we reached a market share for those above 10 megawatts of around 20%.

Revenue for Gas Services in the second quarter was nearly at previous quarter's level, but down year-over-year and came in at €2.6 billion. Growth in the service business of plus 4% was more than offset by a decrease in the new units business. Again, this resulted in a positive favorable business mix in Q2, but with respect to the new unit business, this is mainly timing related.

Profit before special items came in at €381 million. This is above the already high level of prior year's quarter. This is reflecting just over 14% margin. In this quarter in GS, we benefited from a very strong service business, as I indicated before, as well as some positive one-off effects and the Egyptian currency devaluation which had a positive impact in GS of €56 million.

As a reminder, the seasonality in our Gas Service business is such that the mix in the second half, this is typical in all years, particularly in Q4, that shifts towards more of a new unit mix and less service business, which therefore has an impact on the margin. And this year, again, will be no different than in prior years.

Moving on to Grid Technologies business, yet again, our GT business delivered significant improvements across all KPIs on the back of a very strong execution and a very positive market environment, well done to the GT team. Orders in the second quarters exceeded prior year's quarter level by just over 27% and rose to €3.7 billion.

This development was driven by GT's product business and a higher level of Grid solution orders, as Christian just mentioned, for example, the order in Italy, the Adriatic Link, and of course, earlier when we talked about the Q2 awards and milestones. Book-to-bill came in at 1.7 and the order backlog went up to a record €30 billion in GT.

Revenue grew substantially by 25.5% year-over-year on a comparable basis to €2.2 billion with main contributions, as I mentioned earlier, both in the product and the solution business. Profit before special items more than doubled came in strong at €250 million. This is a margin of 11.4%.

This improvement is driven by higher volume, comparatively higher margin in the process order backlog, as well as like in Gas Services, the positive effect related to the Egypt currency devaluation, which had a positive impact of roughly €30 million. Very strong quarter for the GT business, so thank you very much to the team. Well done!

Moving on to Transformation of Industries. Here, TI, they continue to execute towards the goal of further profit expansion and turnaround with a clear focus on maximizing the service share, selectivity to manage profitability, as well as underlying operational execution. This is again reflected nicely in the TI Q2 results.

Orders, second quarter, we booked €1.6 billion. This exceeds the prior year by just over 16% comparable. This increase was mainly driven by a large order in the compression business in the Middle East of nearly €400 million. The book-to-bill came in strong at €1.24 and the backlog rose to €8 billion. And this is up more than 20% versus prior year.

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Looking at the different businesses within TI, we see a continuous positive market environment in our sustainable energy system business, the electrolyzer business, the long term outlook remains intact, but in the short term, we do observe delays in the release of funding commitments due to regulatory uncertainties. And for example, in the U.S. and in Europe, our factory ramp up plans remain unchanged and we focus on the successful execution of projects from our existing pipeline.

Revenue in TI grew significantly by just over 11% year-over-year on a comparable basis with all four independently managed businesses, or IMBs as we call them, at or above prior year quarters level with EAD at over just shy of 28% and the compression business at almost 9% growth, showing the highest growth rates. Revenue growth was supported by the execution of a strong backlog and a continued service momentum.

Service revenue in the quarter increased close to 20% versus prior year. Profit increased, came in at €79 million. This is a margin of 6.2%, particularly in EAD and compression, which benefited from increased volume, especially like I mentioned in the strong service business and better pricing.

So now turning to Siemens Gamesa. Here, as Christian mentioned, he provided you with an update on the status of Siemens Gamesa with respect to quality, etc. Now looking at the figures, orders in the quarter were as expected, sharply down from the prior year and came in at €0.9 billion.

Onshore's orders continue to be impacted by the temporary suspension of sales activities for the 4.X and 5.X turbines. As expected, the offshore and service businesses did not receive any large orders in this quarter, again due to timing. The same quarter in the prior year, for example, included a €1.7 billion order in the UK.

Order backlog, as we continue to convert, decreased to €39 billion and revenue declined moderately by just shy of 5% comparable as lower revenue in the onshore and service business did not more than offset the growth in our offshore business. Profit at negative €448 million. Again, profit continues to be impacted by project margins, certain shifts, and higher plant costs, as we know. And as mentioned earlier, we continue to support guidance for Gamesa in profit at the minus €2 billion-ish level for the year.

So summing up the achievements in total for the second quarter of fiscal year '24, across Siemens Energy, we did better than expected on KPIs. We had a solid quarter in the former gas and power businesses and stability at Siemens Gamesa. Our balance sheet remains strong. We saw another improvement in our net cash position, supported by the strong progress of the underlying business and our ongoing divestment program of non-core assets.

Now, moving on to the financial outlook for the year. The new forecast is based on higher revenue growth assumptions for all segments and higher profit assumptions for Grid Technologies in particular. In terms of free cash flow pre-tax, we expect all segments to exceed the, excluding Siemens Gamesa, I should be clear there, excluding Siemens Gamesa to exceed the original expectations. This is particularly applicable for Gas Services and Grid Technologies, as they are both experiencing strong cash inflows. This is driven by customer prepayments, as we benefit from continuing order growth.

So we now expect Siemens Energy to achieve a comparable revenue growth, excluding currency translation and portfolio effects, in the range of 10% to 12 %. This was previously 3% to 7%. Profit margin before special items is now expected between negative 1% and positive 1%. This was previously negative 2% and positive 1%, unchanged. We expect a net income of up to €1 billion, again, including the impacts from our disposals and the acceleration of the portfolio transformation. And furthermore, we now expect positive free cash flow pre-tax of up to €1 billion. Previously, this was a negative cash flow of around €1 billion.

And last but not least, we expect proceeds from the disposals, as I mentioned before, of around €3 billion, which was previously in the range of positive €2.5 to €3 billion. The amended overall assumptions per business area are there and just reference to the slide.

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And so with that, thank you very much for listening, and I hand over back to Christian. Thank you.

Christian Bruch

Thank you, Maria, and I will keep it very short. The key priorities have not changed for the fiscal year, deliver profitable growth. You've seen that. Fix the wind business and maintain a solid financial foundation, so far, we are well on track and will continue to do our homework. Step after step, I always have to say, right? I mean, it's really a trajectory and going quarter after quarter through this. There's a lot of work ahead of us.

And with this, I look forward to the question-and-answer session. Michael, over to you.

Question-and-Answer Session

A - Michael Hagmann

Thank you, Christian. Thank you, Maria. We will now have just approximately 30 minutes for the Q&A. It's already 11 people that have posted that they want to ask questions. So I would kindly ask you to stick to one question. And as always, if we have time at the end, we will then allow for second questions. The first three questions go to Vivek Midha, Gael de-Bray, and Alex Virgo. So Vivek, if you go ahead. Thank you.

Vivek Midha

Thank you very much, Michael. Good morning, everyone. I'd like to ask about the guidance. The question is, why did you potentially not raise it even more? And if I look more closely at the Grid Technology margin guidance, you've raised the margin guidance to 8% to 10%, but that still implies a lower margin in the second half, despite an acceleration in revenue growth and unlike in Gas. There's no question about service outage patterns. So would you see your guidance is still relatively conservative? Thank you.

Maria Ferraro

Yeah, I'll take that. Hello, good morning, Vivek. Thank you for the question. And maybe let me just further provide some explanation around the profit guidance. So we have narrowed the profit guidance, like you said, effectively, we increased the midpoint by around the 50 bps. Also, as you mentioned, this reflects our raised expectations for Grid Technologies, where we upgraded and increased our profit outlook by around a 100 bps. Again, in line with H1 performance, where we did have a couple of one-off positive effects, but this is, of course, driven by the accelerated and profitable growth. But a large contribution to the revenue upside does stem from Siemens Gamesa.

And here, as you know, we're working through our fiscal year '24 very carefully. But that, of course, comes -- that revenue comes with mostly negative or low margin projects. So as a result, I mean, again, this is why we've narrowed the profit guidance. And of course, if we continue to perform at this level, then of course, it could be the potential that we're at the upper end of the guidance. However, we do maintain the guidance as is between the minus 1% and 1%.

Vivek Midha

Thank you, very much.

Michael Hagmann

Thank you, Maria. Next question goes to Gael de-Bray. Gael, please go ahead.

Gael de-Bray

Around Gamesa, can you now say with certainty that the onshore quality topics and the offshore ramp-up issues are behind the group? And specifically on the onshore side of the portfolio, I guess it will likely take at least a year to rebuild the onshore backlog. So how do you intend to deal with that from the cost cutting and capacity standpoint?

Christian Bruch

Good morning, Gael. I will take that. First of all, what I can say is we obviously have been more or less through the whole fleet. We have not seen any new findings in terms of root causes on the quality measures and we are moving into implementation. And in this regard, this is why we also said it's a good time now to draw a line in the sand and also address a way forward. But keep in mind, and I always want to caution that we will need to work through the matters and also you will see the cash out-flowing over the years to come. It's a long program which we are running, but obviously the team and Jochen has done a good job of bringing these different things together.

Offshore, I think I said it in my words, partly in how we are not there where we need to be, right? In terms of productivity, we're ramping up more people, we're extending the production facilities, but we are not where the productivity level where we want to be, yet. It is improving, but it's on its way, step after step after step, but still work to be done. But this is where I'm seeing the team working in the right direction. So let me call it this way.

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The rebuild of the onshore backlog is a good one. Thanks for that question. It will take longer, right? I mean, very clearly, we start slowly. It will not come to the same amount of sales activity what you're used to see. It's a stepwise uplift and then obviously 5.X only next year. And also keep in mind, once you start the sales process, then it needs time to get the order in, then afterwards until it lands in the factories. So we will have a point in time when we also need to manage capacities, factory load, and whatever.

And this is why we also said very clearly we are looking into this. We do this in parallel with some other organizational measures where we try to reshape the organization, clear accountabilities. That is something what we're discussing internally. So we will also touch organizational structures and also people to be very clear. We're working through the details on that. To adapt also to the focused outlook going forward, it will take, let's say, time really to rebuild this onshore backlog what you're used to, as have been seen.

Gael de-Bray

Okay, thanks very much. And what about the project margin in the backlog for onshore and offshore? Are we still talking about the same levels around low single-digit and mid single-digit, right, on onshore and offshore?

Christian Bruch

Look, on onshore nothing has changed yet, right? Because obviously we are good, or to say, close to a year of sales stop and really have to rebuild this slowly. Offshore, keep in mind the things what we are now contracting is really revenue in '28, '29, right? So that's very long out. Everything else, what has been in, as a result is coming in revenue '25, '26, '27 is really in the backlog. And we're working through this. What has Maria indicated also, this is also the second half and we still remain also with our guidance on Siemens Gamesa with around €2 billion negative loss in total, summing that up.

Gael de-Bray

Thank you very much.

Michael Hagmann

Right, thanks. The next question goes to Alex Virgo. So Alex, please go ahead.

Alex Virgo

Thanks, Michael. Good morning, Christian and Maria. I wondered if you could just clarify the SGRE's free cash flow guidance within that up to €1 billion. Because obviously you mentioned that all other divisions are ahead of expectations. Gamesa remains unchanged, so I just thought it would be helpful if you could clarify that. And then second question, just going back to your provisioning and the original plans around the remediation program. I'm just double checking. If I read through your H1 report, you talk about development of failure rates continues to be closely monitored. But failures observed during this period being slightly higher than expected for certain components. So I just want to work out what that is and what you're referring to there, if that's something to do with the ongoing monitoring or something to do with the 4.X and the 5.X?

Thank you.

Christian Bruch

Yeah, let me take the failure rates and Maria comment on. Good morning, Alex, first of all. First of all, on the quality provisions, what we see with the failure rates is, I think we understand better the diversity of the different factors. I think this is what you see and this is what we're analyzing at the moment. And then obviously you come down to a much more detailed picture. It doesn't lead to the situation that we're changing our accruals on the quality matters. But obviously what we see in certain fleet areas where there's more factors in which determine what it is. It's main bearing from a certain supplier in a certain wind regime and so forth. And then if you would take this specific lot, then you see certain higher failure rates than the average. And this is what we're trying to cluster. It doesn't change our approach to it. But obviously we deemed it necessary to flag that up simply because of the numbers. But as I said, we're still with the same accruals as before.

Alex Virgo

Okay. And I guess there's a flip side of that where this is a function of narrowing down the problem and working out exactly where the bigger issues are rather than necessarily saying there's a change in overall assumptions?

Christian Bruch

Correct, and you would also get additional levers in your hand, right? One example, just to give you a little bit background on this, is okay, certain things we're seeing, okay, how can you adapt the control software, right? And then so you learn additional measures on how you also can rectify things afterwards. And this is what it is about.

Alex Virgo

Great, thank you.

Maria Ferraro

Hi, Alex. Good morning. So maybe going to cash and just to give a bit of context, again, the underlying performance and of course record order intake in the first half year where we have €25 billion in orders that also contributed to that overall very strong cash. If you look at the full year, right now we're at a net cash of €1.3 billion. So after two quarters, we stand at €1.3 billion. I mean, we generated a free cash flow pre-tax around €200 million.

For the second year, we see the cash inflows and cash outflows broadly balanced, which should bring us to a similar net cash position around the level of Q2, so around €1.3 and this is what we're targeting. Because of course we have our cash inflows, you know, the cash generation that we're expecting in H2 in line with our new guidance. Again, the up to €1 billion and on the other hand, of course, we see the regular cash outflows as well related to that. So in summary, we would and I expect that we stay at around the net cash position that we have at Q2. That's where we will land broadly in Q4 at the end of the year.

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Alex Virgo

Great. Thanks Maria, thanks Christian.

Michael Hagmann

Thank you. And the next three questions, go to Akash Gupta, Phil Buller and Sebastian Grove.

Akash, please go ahead.

Akash Gupta

Yes, hi, good morning and thanks for your time. I have a question for Maria. So when I look at your net contract liabilities, they are up to €13.7 billion from €11.8 billion at the end of last fiscal year. How shall we think about development of these net contract liabilities in both near term as well as medium term? And maybe a follow up to that is that at the Capital Markets Day, you guided €1 billion to €2 billion cumulative free cash flow in FY '24 to '26. And just wondering how does that change on the back of increase in 2024 free cash flow guidance? Thank you.

Maria Ferraro

Thank you, Akash, for that. You're right, our net contracts did develop strongly, let's say, with respect to our top-line. How do you think about that in the near term? I think you should think about that broadly speaking again in terms of our book-to-bill greater than one. I think its 11 quarters that we now have a book-to-bill greater than one. We see that order momentum continuing for the rest of this fiscal year. And of course, that is correlated, if you like, and the way those contract liabilities versus contract assets move is correlated to our order development. So we do not see any major swing back or huge or material swing back, neither in the short term nor in the midterm in that regard, based on the continued market momentum, market development and momentum.

With respect to the cash flow overall development, quite pleased. Again, like I said, it's up to €1 billion of cash. Of course, again, that's also correlated to the order development. So we're pleased with that development so far. And of course, we're in the process of determining what that does mean for next year. But clearly, that market momentum has continued into this fiscal year. And we see that growth and that momentum continuing until and into the next year. So that's essentially how you should look at it. Thank you.

Michael Hagmann

Thank you, Maria. And the next question goes to Phil Buller. So, Phil, please, if you could go ahead.

Phil Buller

Yeah. Hi, good morning. Thanks for the question. One for Christian, please, if I may, on end markets. Obviously, the market's very good for grids and gas turbines, but perhaps you can talk about the market share evolution for both of those businesses. And perhaps if you can see differences emerging between maybe gaining share in Europe versus the U.S. And then a follow up on the last question, if I may, on cash for Maria, in terms of the Siemens India topic, obviously, we've had some proceeds, but how should we think about the holding today or how are you thinking about potential cash liabilities and the timing of that as and when the separation of the local equity takes place, please? Thanks.

Christian Bruch

Yeah. Thanks Phil for the question. And obviously, it's a good one. Obviously, seeing that there is, if you take grid, for example, a strong momentum in a couple of regions. However, obviously, Europe is for us leading in terms of the market build out. U.S. we see following, let's say, behind it. There is a reason why we obviously put the factory into the U.S. very clearly because we want to capture that growth and obviously also develop nicely our market share. But at the moment, that is definitely Europe driven in terms of all the HVDC projects which are happening here on the Gas Services side.

As Maria indicated, it was a strong quarter, also with Middle East. Never forget that region and also partly the U.S. If you look on Gas Services, I think you also have to look on what type of turbine are you talking about. Large gas turbines, smaller turbines I think that is a factor what has to be taken into account. And obviously, we are looking into how does this develop and how do we continue to do it in a period where definitely the whole market momentum is positive and the load in the system is high. But definitely, we want to have a good presence in the U.S. also in Gas Services, to be very clear on that.

Maria Ferraro

Thank you, Phil, for the question regarding Siemens India. Of course, this is the Q1 transaction, as you know, completely finalized in Q1 with proceeds of the €2.1 billion. I mean, looking at the future, there it really is also step by step because we now have to look at a carve out and a demerger process that takes some time. And so clearly, this is something that is in a midterm viewpoint, so well into the future. At this point in time, there's no necessity for a liability to be booked because it would be difficult to actually quantify that because there's so many factors between now and then that are not known at this point in time.

Phil Buller

Thank you.

Maria Ferraro

So the same as in Q1 -- as I mentioned in Q1. Thanks, Phil.

Michael Hagmann

Thank you. Next question goes to Sebastian Growe. Please go ahead. Sebastian? Operator, can you check if the line is open?

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Operator

Sebastian, may I request to unmute your line, please?

Michael Hagmann

I'll think we revert to Sebastian then after we hand over to Ajay Patel, who will have the next question. Then thereafter Nick Green, and then Will Mackey, and then thereafter we will revert to Seb.

Ajay Patel

Good morning. Thank you for the presentation. My question is around Grid Technologies. What I'm trying to understand is that you're seeing this fantastic order intake and the book build and I'm trying to understand how much is increasing the length in terms of the number of years of revenue you get from this business and how much can actually lead to revenue increases? Because if we look at this year's target, clearly that number has gone up substantially and I have no real sort of understanding to what capacity you have to add to those numbers as time goes on. So, you know, can we grow the revenue another 20%, 30% next year or are we reaching the limits of the capacity you have before you have to invest behind before you can then accommodate for that higher growth? Is there anything that you can give us to give us the color and the appreciation of the dynamics at play here?

Christian Bruch

Fantastic question, thanks. Thanks very much for that. First of all, I have to say both businesses, you have a short-term running product business and you have a long-term running with this HVDC project, which is then multiple years and then a very long backlog, even reaching out sometimes until 2035 in terms of the planning. Both of them are very good loaded and grow substantially. You have seen for a reason that we obviously increased the factories to cope with this additional growth. We're also driving standardization and frameworks as much as possible to get more through the systems.

But as you rightly said, there is a limit to that in terms of fundamental growth. We have seen a big uplift now. It's our fastest growing business. It will continue to stay on a strong trajectory to be a double digit billion and a double digit margin type of business. But I would also say there's limitations to it. So I would also say don't get carried away immediately on these year-on-year growth rates. We will share new updated numbers obviously with a year-end call and please give us time for it.

And we started obviously some of the capacity extensions also roughly one and a half or two years ago in the background. These are paying off now. That's a good thing. But you can obviously, and I would absolutely agree with this, you cannot continue to grow year-on-year 30%. But as I said, it will be our fastest growing business. It will be a core pillar of our going forward strategy. And let us come back to you with updated numbers by the end of the fiscal year.

Ajay Patel

Thank you very much.

Michael Hagmann

Thank you both. Next question goes to Nick Green. Nick, if you go ahead, please.

Nick Green

Good morning, everybody, and thanks for taking my question. Are you able to give more details around the multi-year recovery plan for offshore or for onshore wind, please? In terms of details of the question here, presumably, you must be facing a strategic bouncing axe between the volume of units you hope to sell in the future, the price of those units, and then the cost base. Now, it may not be within your influence to achieve a higher selling price, in which case your choice seems to be to get the margin up to, number one, materially cut that operating footprint and lower the cost base, or two, and it's perhaps counterintuitive, simplify the product and sell it at a much lower price to ensure sufficient volume to support the marginal throughput. Can you please discuss the merits of either cutting your cost base or potentially simplifying and cutting your average selling price in the event that the market doesn't support a higher selling price as you hope? Thank you.

Christian Bruch

Yeah, thanks, Nick, for the question. Obviously, as you rightly said, that is a long multi-year plan which we are now embarking on, and this will unfold over several years. I look on the market much more regionally than we used to do in the past, and I obviously also look, first of all, from a product perspective. One thing which we have been doing or what Jochen has been doing with his team over the last 12 months is to substantially reduce the number of variants of the different products to simplify the process.

I would not call it simplify the product because it's still a product, but simplify the variations. How do you then do procurement for it? How many different specifications you can have, and it's a simplification in these type of processes which allow obviously also to tackle costs in terms of what are you paying for your sourcing? How could you get productivity up in the factories, which is a tremendous factor in the overall cost base, and you shape your regional footprint towards that. Because you have that product, that is a region you're going to tackle. That's a bit the logic. Obviously, at the end, to have a cost base which allows you to, even at a lower volume range, to earn some money.

In the hindsight, it means there's, let's say, regions or certain variants which we will not support anymore and where we cut or shut off or hand over, and this is at the moment under definition, but you will definitely see us touching the organization in terms of getting adapted to this. The other thing is, obviously, keep in mind that we are working through a trough where we have a low in revenue and onshore and only gradually going to return. Also, this will have consequences, but simplifying also the footprint, you may know that we also discussed, I think, on the Capital Market Day a bit, the make versus buy discussions. That is also an element of that where we simplify our back office or, let's say, factory infrastructure.

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That is part of that, but I also think at the end, it's really about this regional and product focus. It's not so much about lowering ASP prices. This is not what I'm seeing, and keep in mind, we also will balance it service and new unit and onshore. We will offer services for our onshore turbines, and for us, it is important that we provide reliable and really planable units, and this is where we have to get better, and simplicity in the product variants will lead to that. And that is a core driver for us, which means more focus in regions and more focus on products.

Nick Green

That's very helpful, Christian. If I could just have a short follow-up, please. If possible, are you able to give any color around the timing of Jochen leaving? It just seems a little odd for a turnaround guy to be leaving before the turnaround has established.

Christian Bruch

No, Nick, thanks very much for the question. I think that is absolutely important, because honestly, this is what I said, right? I would love to have it probably to do a year later. We are not through with the restructuring. The reason why Jochen and I decided to do it now is because of some changes in the organization according to the long-term forward-looking plan. We are doing so many decisions at this point in time over the next six months, which determine the next three, four, five years. And we said we don't want anybody to come in 12 months or 15 months down the road and say, guess what, I changed a bit.

Then we want to have a stable organization, also give the clear message to the organization to say, the things we are doing now, we are doing for the future, and they are going to be with you for a longer time really to fight back. That is the key logic behind it. Jochen will stay around, as he said, as long as we need him, and that is good, because he has done an excellent job. He's one of the best turnaround managers, which I know in the industry. So that was a bit the logic where we had to find the balance. There is never an optimum time for that.

Nick Green

Thank you.

Michael Hagmann

Thank you. Next question goes to Will Mackey. Will, please go ahead.

Will Mackie

Hi, good morning. Thanks. I'm going to stick with Siemens Gamesa for a moment. I think you've just described there's so many decisions to happen over the next six months, the timing of re-entry into the onshore, the ramp up in the offshore. It was only November that you presented a turnaround plan for Siemens Gamesa with a target of reaching breakeven by '26. I mean, how should we think about that mid-term projection now, given there seem to be another set of moving parts ahead of us?

Christian Bruch

Thanks. Please don't, I hope we didn't confuse it, right? What we said in November holds to the same logic, what we did over the last months, detailing out the time thereafter. Where do we take it to? The plan towards '26 has not changed. And obviously, the program is set up, will be executed, and that is what the team is lining up. What we wanted in the last months really to define, how does it look until the end of the decade? What business is interesting? Can we make certain parts of the business successful, or if not, do something else with it? This is what we worked on, but that is really particular for the time.

And this is why I said long-term strategic plan after '26. It doesn't change the other measures, which will be heavily influenced by working through the existing offshore order backlog and ramping up the facilities, and obviously implementing the quality changes. Important for us was, do we believe we can make it a long-term successful business? This was the work which was happening now, doesn't change anything from the pictures which were laid out last Capital Market Day.

Will Mackie

Thanks. A follow-up, please, if I may?

Michael Hagmann

You're running up against the hour, Will. And there's still a couple of questions in the queue, sorry. But just to be fair, if that's okay. I'll call you later. So, next question goes to Sebastian Growe then, before we hand over to Max Yates and Sean McLoughlin, which would then conclude the call. So, over to Seb, please.

Sebastian Growe

Thanks, Michael. Hi, Maria, Christian and sorry for that technical issue here. First one on GT outlook, you raised the organic growth target to more than 30% for 2024. Last 12 months, book-to-bill is above 2. And obviously, the sales now is about €10 billion or a little lower in fiscal '24, whereas the order intake is more than €15 billion. So, you mentioned the capacity increase, etc. You have a double-digit, low double-digit midterm growth target. So, how long might it take to really grow into this kind of €15 billion new dimension? And if I may have a quick follow-up on the 4.X relaunch, why hasn't this been synchronized with the 5.X? Have you realized any unexpected challenges here? So, that would be my two questions, thanks.

Christian Bruch

Yeah, I mean, on the growth, I mean, we obviously, with Grid Technologies regard, we're going to share that by year-end call in terms of doing this, in terms of how long does it take? Keep one thing in mind with a larger project, in particular. It's not always us who is the bottleneck. There's cables, there's investment plans, there's regulatory. And this is obviously also what we have to take into mind to define how fast unfold certain things into revenue. And, but as I said, we are working through the details to say that is now the revised plan and we're going to share that by the year-end call.

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Why has 4.X and 5.X not been harmonized? It is a different product and it touches different markets in terms of different wind regime where you're going to apply that. It's not the same market. And obviously, on the 5.X, which is a newer product where we also said we want to look on several solutions before we relaunch it. That was simply part of the overall program in terms of looking on revised designs. And at the end, it's also regionally different market and wind regimes. So I think the staggered approach makes absolutely sense.

Sebastian Growe

Thank you.

Michael Hagmann

Thanks. Max, next question goes to you. And if you could keep to one question, that'd be great.

Max Yates

Yes. Thank you. Good morning. I'll be quick. I guess my question is if I look across all of kind of power infrastructure, I think about the cable companies that I look at that you do some of these projects with, everyone is talking about margins on new orders that they're taking today being significantly higher than where they were three or four years ago. And I guess my sort of simple question is, is there any reason for the products that you do when we think about supply-demand tightness in the industry shouldn't also be seeing much higher margins on the orders that you're taking today versus three years ago?

Christian Bruch

Well, this is a true statement, right? And we said we have a good pricing regime and an improving margin on the backlog. So we are happy with that in terms of how this is developing. At the same time, obviously, it will be always a balance in terms of, okay, where is this going to, what is the overall cost for the grid build out? Because it will cost more money than people expected, but definitely the margin and pricing improvement has been better. Keep in mind, for long term, years ago, this business has not earned the capital cost.

The other thing which I think is important apart from pricing is really the T's and C's. And that is something where the risk-reward profile is much more balanced than it used to be in the grids contracts where the industry finds a way, obviously, to share fairly risk and rewards across the different contracts.

Michael Hagmann

Thank you. And the very last question goes to Sean McLoughlin. Sean, please go ahead.

Sean McLoughlin

Thank you. Just a quick one from me, continuing on with Grid Technologies. When do your new factories in the U.S. and India actually start generating revenues? And just wondering on a three-year view, is €600 million CapEx that you announced back in the Capital Market Day, is enough to keep up with the demand environment that you're looking at?

Christian Bruch

Yeah, the last question I would once again revert to the really when we review our outlook and get back after the fiscal year to you in terms of so far everything we have communicated the Capital Market Day stands as well. And, oh boy, what was it?

Maria Ferraro

Revenues.

Michael Hagmann

When we will generate revenues out of the U.S?

Christian Bruch

I'll say, sorry. I think, it was a long or was it early morning? And normally, obviously, we have started, how you say, the foundation laying, right? But expect roughly two years when the factory is going to start to produce.

Sean McLoughlin

Thank you.

Michael Hagmann

Thank you. And with that, I would hand over to Christian for some closing remarks.

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Christian Bruch

Thank you very much. And I just want to still say, right, we are happy with the quarter but it's also step after step. It is a business which takes time, its lots of things ahead of us. We have to work through the quality matters in Siemens Gamesa. This will be a long, long period. But I really would like to thank the Siemens Energy team of having done a tremendous job.

And obviously, thanks very much for your attention today. Stay tuned and speak to you soon.

Michael Hagmann

Thanks, everyone.

Operator

Thank you very much. That will conclude today's conference call. Thank you for your participation, ladies and gentlemen. A recording of this conference call will be available on the Investor Relations section of Siemens Energy website. The website address is www.siemens-energy.com/investorrelations. Thank you.

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