14-Jul-2022

Momentum Group AB (MMGR.B.SE)

Q2 2022 Earnings Call

CORPORATE PARTICIPANTS

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MANAGEMENT DISCUSSION SECTION

Ulf Christian Lilius

President & Chief Executive Officer, Momentum Group AB

Welcome to the presentation of Momentum Group's Interim Report for Q2 2022. I'm Ulf Lilius, CEO from Momentum Group; and I'm here with my colleague, Niklas Enmark, Executive Vice President and CFO, and we will guide you through our report today.

Our agenda today is to give you some information about the highlights from Q2 and the development during the quarter and information about the financial targets. We will round off with the focus going forward as well as give you information about our acquisition process.

Highlights from the report. We had a continued good underlying demand in both our business areas during the second quarter. Component shortages, acquisitions, and focus on organic improvement measures characterized the second quarter of the year. The group showed organic sales growth, which, in combination, with good cost control and well-managed price increases from suppliers contributed to an EBITDA increase by 23% compared with the second quarter last year. And our EBITDA through working capital remain stable at 62%.

Now I will hand over to Niklas who will guide you through our Q2 report.

Niklas Enmark

Chief Financial Officer & Executive Vice President, Momentum Group AB

During the second quarter, revenue increased by 13% compared with a year earlier period amounted to SEK 446 million. Growth in comparable units was about 8%. HNC Group was acquired during the quarter and acquisitions added in total 6% to revenue growth in the quarter, which included one trading day less than the corresponding quarter in the preceding year. As Ulf mentioned, general demand was favorable. And during the second quarter, the turbulence in the markets have not yet had an intangible impact on customer behavior.

The shortage of components that characterize the year has stabilized, but is still causing long delivery times. However, the company's customers have been understanding of the situation and we are nevertheless maintaining high delivery capacity. The group has successfully offset price increases from suppliers.

Looking ahead, the continued global impact of COVID-19, the security situation and the possibility of an economic downturn are expected to impact the market going forward. The group is therefore implementing ongoing measures in its operations to adapt them to the prevailing demand situation. As in the past, the group's decentralized structure where decisions made close to customer suppliers has proven to be a major strength in this regard.

EBITDA increased by 23% to SEK 54 million, corresponding to an EBITDA margin of 12.1% during the quarter, with good performance in both business areas. Operating profit rose by 17% to SEK 49 million, corresponding to an operating margin of 11%. Operating profit included expenses affecting comparability of minus SEK 2 million related to the separate listing, which mainly pertain to advisory and review costs. The project is now closed and the costs for Momentum Group have amounted to SEK 12 million compared to the estimate of SEK 30 million. Also, our operating profit was affected by slightly higher amortization from acquisitions compared to last year.

The main drivers of our profit expansion during the quarter were the organic sales development mentioned, acquisitions, good cost control and being able to compensate for the increased costs from suppliers. Of course, our personnel costs were also higher, due to the fact that due to the fact that we have approximately 100 more FTE compared to last year as well as through higher sales activities.

For the reporting period January to June, revenue rose by 13% to SEK 845 million. The increase in revenue for comparable units was approximately 9%. The reporting period contained the same number of trading days as the year earlier period. Acquisitions added in total 4% to revenue growth in the period. EBIDTA increased by 21% to SEK 98 million, corresponding to an EBITDA margin of 11.6%. Operating profit rose by 12% to SEK 86 million, corresponding to an operating margin of 10.2%. Operating profit included expenses affecting comparability of minus SEK 6 million related to the separate listing.

Now, a few comments per business area, starting with the components business area. Sales and earnings in the components business area were positive during the second quarter where revenue rose by 12% to SEK 358 million compared with the same quarter last year. Revenue for comparable units measured in local currency and adjusted for the number of trading days rose by approximately 7%. EBITA amounted to SEK 50 million, corresponding to an EBITA margin of 14%. The business area's profitability, measured as return on working capital, continued to be strong and amounted to 73%.

Looking at the individual companies. Momentum Industrial reported favorable sales growth in the quarter with strong growth primarily noted in the pulp and paper customer segment and the steel sector. However, delivery disruptions and component shortages had a negative impact on sales in the quarter and resulted in long delivery times. Some additional purchases were made during the period to ensure higher delivery capacity.

The specialist companies all delivered a positive performance during the quarter and the impact of delivery delays and material shortages continues to be felt, but in certain areas have improved somewhat, resulting in fewer backorders. During the quarter, HNC Group has acquired a leading player in solutions for industrial automated – automation in Denmark. HNC contributed positively to earnings for the quarter.

Turning to the services business area. The services business area performed well during the quarter in terms of both sales and earnings. Revenue rose by 19% to SEK 93 million compared with the corresponding quarter of the preceding year. Revenue for comparable units measured in local currency and adjusted for the number of trading days, rose approximately 14%. EBITDA amounted to SEK 9 million corresponding to EBITDA margin of 9.7%. The business area's profitability measured as return on working capital continued to improve and stood at 55%.

As we mentioned in the last report, we are working to increase the profit margin in the business area and we saw a good improvement from the companies. Thanks to high capacity utilization in general for our workshops. Our largest companies, Roric and Mekano companies made strong contributions to the result of this quarter. The companies continued to experience prolonged delivery times and shortages of certain spare parts and components. This mainly had a negative impact on certain major renovation work industrial sales. Earlier this week, it was also announced that we would acquire Mytolerans, which offers products and services in measurement technology for the Swedish industry. The acquisition is expected to be completed in August.

The group's profitability measured as return on working capital. EBITA over working capital increased to 62% for the most recent 12-month period. Cash flow from operating activities before changes in working capital for the reporting period [indiscernible] 00:08:10 total SEK 46 million. The decrease compared with the preceding year is the result of two things mainly: paid tax of SEK 47 million, a large proportion of which concerned supplement repayments, recorded tax for the previous financial year. And secondly, inventories increased by SEK 33 million.

The latter is based on active decisions to make extra stock purchases in Momentum industrial support of delivery capacity to our customers. Other items that affected cash flow during the period was the acquisition of HNC Group, a purchase of the remaining shares in the [indiscernible] 00:08:49 who now owned 100% as well as a share buybacks in total of SEK 58 million. The IFRS 16 effects on cash flow is in total zero, but with a positive contribution to operations of SEK 25 million and the negative effect on financing in the same amount. I should also add that we have included the IFRS effects for previous periods in an appendix slide in the presentation.

Looking at the financial position at the end of the period, the group's operational net loan liability amounted to SEK 25 million. Cash and cash equivalents, including unutilized granted credit facilities, totaled SEK 984 million, meaning, we have ample room for continued growth and a strong financial position. Moving on, we would like to discuss our financial targets and how we think about them. As mentioned before, we have one target related to our growth, meaning, we should grow our earnings measured on EBITA level grow our earnings measured on EBITA level of at least 15% annually over a business cycle. Over five years, this means that we should double our earnings level.

The other target profitability means to achieve profitability or working capital of at least 45%, measured as EBITA in relation to the utilized working capital trailing 12 months. This is really a form of cash flow target. If we turn our working capital sufficiently enough and generate a good profit margin while we do so, this should generate a good cash flow from operations. Generating this cash flow means we should have ample means to reach our third financial objective, to have a good dividend over to our shareholders while being able to invest in existing and new businesses.

Looking at the performance in relation to these financial targets. Firstly, I should mention that we see them as long-term objectives. Nonetheless, looking at them quarter by quarter in these last three years, we note that, firstly, our EBITA growth quarter-over-quarter was an average 18% for the period June 2019 until June 2022, which is above the target level of 15%. The quarters where this target was not met was the pandemic years 2020 until 2021.

Looking at the composition of the EBITA growth, about two-thirds have been achieved through revenue growth, both organic and through acquisitions, and about one-third through improvement in gross margin, which has been mostly organic. Our profitability or working capital has increased to 62% from 46% in March 2019 through gradual improvements in EBITA margin and capital turnover, as you can see from the chart. Both are important for us as a group and we measured this for each property unit. Internally,each product unit. Internally, we work with something we call our focus model, giving priorities based on different levels of profitability, thus being a good tool for setting up activities in our annual business planning.

The focus model means that if a company is above 45%, the ambition is to increase profits while maintaining a good profitability through revenue increases, both organic and acquisitions, that is, to grow the business and the profit level. If the business is below 25%, the focus is to increase margins as we see this as the best way for increased profitability based on our experience. This could be done through cost as well as gross margins, but not primarily with a focus to sell more. For a company between 25% to 45%, the goal is to increase margins, as well as working capital turnover to reach a proof of concept.

With that, I would like to hand over to you again, Ulf.

Ulf Christian Lilius

President & Chief Executive Officer, Momentum Group AB

Thank you, Niklas. Now we'll give you some input about our focus going forward. In order to grow our business, we have a framework to work by. We call it our mind and soul and heart and soul. The mind and soul is to have business development in companies through decentralized responsibility and in each company employee development. We also like to be an active owner and work with the companies to find new opportunities to grow and develop the business, as well as grow through acquisitions. Secondly, we work with heart and soul. To achieve this, we believe very strongly decentralized responsibility as well as the willingness to improve. We call this to be better than yesterday. And to be able to be better than yesterday, we have to work with simplicity.

Now we will round off with the information about the recent acquisitions and the process we have for doing acquisitions. During the second quarter,we acquired 70% of the shares in HNC Group with its fully owned subsidiaries HNC technique in Germany [indiscernible] 00:13:57. HNC offers components as well as customized solutions for automation and process optimization for customers primarily in the food and pharmaceutical industry and for machine builders.

HNC has successfully commercialized its own product range of kinetic stainless steel cylinders sold under the unique brand that offer a number of advantages over other materials, such as aluminum, especially in demanding production such a food and farming industry.

Through the acquisition, the group also has an interesting footprint in Germany, a market that we think can be further explored and developed. HNC has a sales of approximately SEK 60 million and just over 30 employees and it's included in the group of specialist companies within the business area components.

Earlier this week, we also announced an acquisition of 70% of the shares in Mytolerans. Mytolerans sells mechanical and optical measuring machines for quality control, follow-up and process controls, as well as service and calibration for Swedish industrial customers. Mytolerans [indiscernible] 00:15:02 of approximately SEK 35 million and 10 employees. Mytolerans will be included on the group of value-adding companies, focusing on measuring quality assurance and optimization that we're building now, compromising two companies.

Both HNC and Mytolerans acquired, we have a proven model. We initially acquired 70% and has an option to acquire the remainder after three years. We have identified a number of product and service verticals where we like to be present. We group the companies in our three focus areas based on these. In the aftermarket group, we combined a strong value offer with broad and deep product offering coupled with related services and expertise in industrial improvements. In our specialist companies, we focus on building expertisein a limited number of verticals per company. For example, [indiscernible] 00:15:52 hydraulics and advanced pneumatics, and now HNC Group informatics and automation. The third focus area is technical services where we today have the companies that do make the service on and off customer sites, as well as like refurbishments of gear, motors, pumps, generators, and spindle service. We also have companies working in measurement, quality assurance, and optimization.

We think a degree of focus as regards business development and acquisitions are an important success factor. As we grow and develop our offer, market the knowledge, we can then add adjacent product verticals with limited risk and higher chances for success. A decentralized business model is a key where we develop each company individually based on its own merits and as a group, build on competencies in several industrial species. Looking ahead, we have a strong platform and good businesses, which means we can work with a strong focus as a niche compounder within our selected product and service verticals.

Niklas will now guide us through our acquisition process.

Niklas Enmark

Chief Financial Officer & Executive Vice President, Momentum Group AB

Thank you, Ulf. And looking at the acquisition candidates we normally approach where we want them to exhibit a number of characteristics. They should have a strong and defendable position in the value chain with a well-developed customer and supply – supplier relationships with an ambition to further develop these into strong partnerships. As we focus on certain verticals, we look for companies that are market leaders or have the potential to become market leaders in these verticals. We define a vertical in terms of several layers, including, one, which type of business it is. For instance, if it's off the market or when 00:17:38 second, place in the value chain; third, type of offer

chain. Third, type of offer if it's spare parts, services for installations, for instance. Fourth, which technology area it is, for instance, hydraulics. And five, customers and market applications, for instance, if the target is food and beverage industry, pulp and paper, etcetera.

Finally, we see companies that are profitable and through various activities can become even more profitable or grow with existing level of profitability. The target companies should be or have the potential to be at least a 10% EBITDA margin company, meaning we should turn our working capital about 5x to achieve a sufficient profitability.

In order to achieve a high number of acquisition candidates and be able to process in a diligent manner, we have established an M&A process that is easy to follow and is sufficient. It starts with a growth screening where we identify companies based on the criteria, as mentioned before, but where we also have the parameters of transaction feasibility based on ownership structure and at least soft values. Do we think that the company and its entrepreneur will fit in our group and also add to the further development of us as a company.

We work our way through the process, through meetings and further analysis, which we summarize in a short form, which also must include a value creation plan. We run our acquisitions with our own personnel, a team comprises normally one commercially responsible and one to two process-oriented people. These are the same people that will follow and support the company also after an acquisition. As of today, we have 10 people being involved in the screening, execution and M&A support in the group, including group management, business area management and CFOs.

We seldom participate in structured processes and if we do, we must have some form of exclusivity down the road as we invest a lot of time and effort in these processes. We think it is important to have a clear communication and easy access throughout this process as these things always materialize. That needs to be solved. This also builds trust for the continued journey.

The acquisition process is just not a process for closing of the transaction. It is also a basis for getting to know the company we are acquiring and its people. That is one important reason why we staff these processes with our own people. This is established through a common view on key issues, culture, business acumen, organization, etcetera. Further, we developed a joint strategic plan linked to a model of increased value creation and often with joint ownership over a defined period through our option model, and now also with the possibility to offer a shareholding in Momentum Group through own shares.

As is often the case, the target company already has a clear vision and plan on what they would like to do, which is one of the reasons why they seek a new partner in us. Meaning that we from the start can implement activities. Further, we talk onboarding and not so much integration. It is important that the transition to us as owners is not a revolution, but an evolution. Therefore, we try to maintain as much as possible in the company not a risk culture and business acumen and too much income and focus.

Our onboarding plan does prioritize financial reporting, board work and activity planning as well as the low-hanging fruits in terms of cost synergies, making the company part of the group's common agreements for financial services and insurance, for instance. We would as soon as possible like to reach the third phase active board work where we work jointly with the continued development of the company. Further down the road, we have a number of two boxes that we work with together with the management in the company, exploring optimization possibilities and growth initiatives.

Our belief is that, we have critical success factors in place to succeed with our strategy. We are financially strong with room for acquisitions. We have a strong cash flow from operations and the possibility of acquisition financing through our revolving facility of SEK 800 million. We have principal owners who wants to grow the group in our desired position.

We have a good industrial network, mainly in Sweden, but also in Denmark, Norway, and Finland. We have a proven process and resources and a team of around 10 employees who work on acquisitions in various forms, in place to evaluate and implement acquisitions, as well as an approval on board involvement with decentralized performance and business responsibility.

And we have competence in our field at several levels from the board and management as well as in our companies. So bottom line, we're not that complicated. We acquire, we develop, we build culture and we believe if people grow, the business will grow. So we will now go over to a Q&A session as we have received some questions regarding the report. And I will ask the first questions and we'll give answers and then, we'll reverse it.

QUESTION AND ANSWER SECTION

A

So have you experienced any difference in customer behavior during the quarter? Have customers shown any tendency to become more cautious? Also, your best view on organic growth outlook for the second half of the year based on the visibility you have. And if we do end up in a recession, with more severe impact on general demand, how can you balance that in your operations?

on your demand, how can you balance that in your operations?

A

Well, we saw stable customer behavior during the quarter with good demand in both business areas. As we commented in the report, we have not seen an intangible impact from the surrounding market turbulence or customer behavior. Our business is mostly related to aftermarket sales with pretty short lead times. Therefore, we're not making any longer term projection, but rather face our market here now. Every new economic downturn has its own characteristics. Looking at the two last crisis, the financial crisis in 2009 and the start of the pandemic in 2020, we all oversee that our business has been resilient, exhibiting a sales drop of less than 10% over the course of the crisis.

Also, one other thing to mention is that our profitability is not built on scale effects, meaning we have been able to defend a good profit level also in turbulent times. We will face a potential downturn and even a recession, as we always have done with direct actions in our companies, that taking measures in the companies based on the conditions they meet. Here, our decentralized mode of operation is really a strong point.

Q

Thank you. How has the business units in services historically managed economic slowdowns, customers within [ph] Form and Foods 00:24:56 sounds more resilient if you compare it versus automotive, for example.

A

That's true, that some of our customer segments are more resilient than others in a volatile market environment. However, it's important to remind of our two type of businesses, working with the aftermarket sales, repairs and services to a large extent. We're not as exposed as a company selling components to cars, trucks, etcetera. As long as the customer maintains production, there will always be a need for products and services.

Q

Thank you. Stable increasing gross margins over time, is this sustainable or should we expect to move down towards the historic level in the mid-term? What's the reasons for the strong margin now and why is it potentially should change upward or downward?

A

There are a number of reasons by the increase in gross margins over time. We continuously work with value-adding an offer that customers see benefit in and are willing to pay for. Also, there is a mix effect that we have increased the level of sales from services which has a higher gross margin. Finally, we have been able to mitigate the price increases from suppliers in a good way. Gross margin is one of the most important parameters that we follow in our companies, and we are always working to maintain it on a good level given the conditions we face in the market.

Niklas, we have also got a question about the cash conversion was affected by higher paid tax and high inventory levels. Are inventory levels to remain as high as now to support growth or an opportunity to release working capital when the supply chains normalize?

Niklas Enmark

Chief Financial Officer & Executive Vice President, Momentum Group AB

A

As we mentioned in the report, our cash flow from operations was affected by the tax item and the buildup in inventory due to extra stock purchases. We see the latter as a way to secure a good delivery capacity to our customers, given there's strains in the market when it comes to the supply chain. In a more normal environment, we see that the inventory levels to be balanced. However, maintaining a good inventory level is always key for us as availability is one of our competitive advantages. So, as we grow, we will build up inventory in absolute numbers. But, in relation to sales, the ratio is quite stable, which also can be seen in our working capital turnover.

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Have you seen an improvement in the supply chain?

A

The situation is still a challenge but has stabilized. In some areas, we also see improvements. However, important to keep in mind is that this is a general problem. We meet our customers each day and there's a lot of creativity out there trying to mitigate the challenge. We are not experiencing and we are losing businesses on this. But in some cases, this is actually a way of deepening our relationship with our customers, showing them we can also support them in turbulent times.

A

Thank you. We also got some questions about the M&A journey in the near term, given the equity market volatility, interest rate increases, etcetera. Is it easier or tougher to make deals in this environment? Have you lost any deals were in the pipeline to other acquirers of late?

A

Well, we have not seen any significant impact on the activity when it comes to M&A. We see that many of our target companies experienced the same situation as we do, a pretty stable demand and decent profit levels. We have not seen any real effect on the multiples either, even though one could expect to see a change based on the stock market drop and interest rate increase. However, this effects on the private M&A side tend to lag the public market a bit. We continue to work diligently with our pipe and processes as before. Of course, we don't close all the deals we are initiating. In some cases, we halt or actually stop the discussion when we see that the price gap cannot be negotiated.

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Thank you, Niklas.

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So we have also received the question about the IFRS 16 effects on the cash flow on the historical levels, and we have included one slide in the presentation that describes the historical levels of the cash flow. And I should say that the net effect is of course zero, but this is affecting two different items in the cash flow, as you can see here on the slide.

Unverified Participant

Finally, I would like to thank you for your time and the interest listening to this presentation. The presentation shown today and the report is also on our website.

If you have any questions or specific requests, do not hesitate to contact us through our IR mail or by phone. Thank you for your time.